REFORM OF THE UNEMPLOYMENT COMPENSATION PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

DECEMBER 14, 1987

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REFORM OF THE UNEMPLOYMENT COMPENSATION PROGRAM

MONDAY, DECEMBER 14, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON PUBLIC ASSISTANCE AND
UNEMPLOYMENT COMPENSATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room B-318, Rayburn House Office Building, Hon. Thomas J. Downey (acting chairman of the subcommittee) presiding.

[The press releases announcing the hearing follow:]

FOR IMMEDIATE RELEASE
THURSDAY, OCTOBER 22, 1987

PR #7
SUBCOMMITTEE ON PUBLIC ASSISTANCE
AND UNEMPLOYMENT COMPENSATION
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1025

THE HONORABLE THOMAS J. DOWNEY (D., N.Y.), ACTING CHAIRMAN, SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES SUBCOMMITTEE REVIEW OF THE UNEMPLOYMENT COMPENSATION PROGRAM

The Honorable Thomas J. Downey (D., N.Y.), Acting Chairman of the Subcommittee on Public Assistance and Unemployment Compensation, Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will conduct hearings on the need to reform the Federal-State Unemployment Compensation (UC) system. Further details and specific dates for the hearings will be announced at a later date.

The Social Security Act of 1935 created the Federal-State Unemployment Compensation (UC) system. It has two main objectives: (1) to provide temporary and partial wage replacement to involuntarily unemployed workers who were recently employed; and (2) to help stabilize the economy during recessions. The U.S. Department of Labor oversees the Federally-approved State programs, plus programs in the District of Columbia, the Virgin Islands, and Puerto Rico.

The hearings will focus on several questions concerning the condition of the existing unemployment compensation programs:

(1) Do the States have sufficient reserves in their unemployment funds?

(2) Do existing programs provide adequate coverage of the workforce?

(3) Would the current Federal/State Extended Benefit program provide the additional protection needed during a period of high unemployment?

(4) Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions that have been enacted in recent years in these programs?

In announcing this review of the UC system, Acting Chairman Downey stated, "I am particularly concerned about the financial condition of the system and its ability to provide adequate benefits to the unemployed during periods of high unemployment." In this regard, the Committee is especially interested in views on H.R. 2676, the Extended Unemployment Insurance Act of 1987, introduced on June 11, 1987, by the Honorable Don Pease (D., Ohio), the Honorable Sander M. Levin (D., Mich.), et al.

Individuals interested in testifying at the hearings should contact the Subcommittee staff at (202) 225-1025 to discuss the issues and express their concerns.

*****

FOR IMMEDIATE RELEASE
MONDAY, NOVEMBER 30, 1987

PR #8
SUBCOMMITTEE ON PUBLIC ASSISTANCE
AND UNEMPLOYMENT COMPENSATION
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE THOMAS J. DOWNEY (D., N.Y.), ACTING CHAIRMAN, SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON REFORM OF THE UNEMPLOYMENT COMPENSATION PROGRAM TO BE HELD ON MONDAY, DECEMBER 14, 1987

The Honorable Thomas J. Downey (D., N.Y.), Acting Chairman of the Subcommittee on Public Assistance and Unemployment Compensation, Committee on Ways and Means, U.S. House of Representatives, today announced the date that the Subcommittee will conduct a public hearing on the need to reform the Federal-State Unemployment Compensation (UC) system on Monday, December 14, 1987, in room B-318 Rayburn House Office Building, beginning at 10:00 a.m.

As announced in the Subcommittee's press release #7, dated October 22, 1987, the hearing will focus on several questions concerning the condition of the existing unemployment compensation programs:

(1) Do the States have sufficient reserves in their unemployment funds?

(2) Do existing programs provide adequate coverage of the work force?

(3) Would the current Federal-State Extended Benefits program provide the additional protection needed during a period of high unemployment?

(4) Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions in these programs that have been enacted in recent years?

(5) Are there alternative uses of UC funds that could improve the efficiency of labor markets?

In announcing this review of the UC system, Acting Chairman Downey stated, "I am particularly concerned about the financial condition of the system and its ability to provide adequate benefits to the unemployed during periods of high unemployment. Also, I am interested in alternative uses of UC funds that could put unemployed persons back to work sooner without additional costs to the system." In this regard, the Subcommittee is especially interested in views on H.R. 2676, the Extended Unemployment Insurance Act of 1987, and H.R. 3213, the Unemployment Insurance Reemployment Demonstration Projects Act.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-1721] no later than close of business, Wednesday, December 9, 1987, to be followed by a formal written request to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline.

(MORE)

Any questions concerning a scheduled appearance should be directed to the Subcommittee [(202) 225-1025].

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. (See formatting requirements below.) This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 75 copies of their prepared statements to the Subcommittee office, Room B-317 Rayburn House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Persons wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business, Wednesday, December 23, 1987, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and interested public, they may deliver 75 additional copies for this purpose to room B-317 Rayburn House Office Building on the date of the hearing.

SEE FORMATTING REQUIREMENTS BELOW:

COMMITTEE ON WAYS AND MEANS FORMATTING REQUIREMENTS FOR PRINTING OF HEARING STATEMENTS, WRITTEN COMMENTS AND EXHIBITS

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Acting Chairman DOWNEY. Good morning.

The Subcommittee on Public Assistance and Unemployment Compensation will come to order.

The general subject of today's hearing is reform of the unemployment compensation program.

The committee is also interested in testimony on H.R. 2675, the Extended Unemployment Insurance Act for 1987, and H.R. 3213, the Unemployment Insurance Re-employment Projects Act.

I am particularly concerned about the ability of the system to respond to the next recession. Will reserves be sufficient to cover increased outlays, and will benefits be adequate? If the system continues to experience financial difficulties, it might require further Federal action.

Today the subcommittee will hear testimony from three Members of Congress and five panels.

First, I am pleased to welcome our colleagues William Coyne, Sander Levin, and Bill Clinger, none of whom are here—oh, one of them is here.

Mr. Clinger, if you would come up.

After they have an opportunity to testify, the subcommittee will hear from the five panels. I look forward to your testimony on one of the Nation's most vital safety programs. Are there other members of the subcommittee who would like to say something? Don, do you have an opening statement?

Mr. PEASE. Thank you very much, Mr. Chairman. I would like to make a brief opening statement.

I'd begin by expressing my appreciation to you for scheduling this hearing.

It's been quite a while since the subcommittee has taken up unemployment questions. Unfortunately, unemployment insurance is one of those kinds of issues that Congress only seems to be able to work on when a crisis is upon us. Luckily, we are not in that situation today.

Judging from the response to the announcement of this hearing, there seems to be a lot of pent-up demand to take a look at unemployment insurance. By the time we are through today, I think we will have a great deal to think about over the coming recess.

The month that I was elected to Congress—November of 1976—the country's civilian unemployment rate was 7.8 percent. At the time, that was considered to be severe unemployment, and it was a major factor in President Ford's election defeat that year.

During the following 4 years under President Carter, the rate dropped below the 6-percent level for a short while, but his administration never received any credit for really fighting unemployment.

Today the unemployment rate is 6 percent, and it hardly registers on the national consciousness.

Our response to unemployment at the Federal level has traditionally been a limited one. We have a program of unemployment insurance which was designed decades ago to respond to conditions prevailing in the work force at that time.

Essentially, what we do is provide a limited income security payment intended to tide over the unemployed worker and family

until—in the traditional case—the layoff was over and the worker returned to work.

In recent years we have seen a new type of unemployment—workers whose jobs or industries simply disappear. For these workers, there will be no end to the layoff and no call back to work.

Yet, the unemployment insurance system still treats them as if they were going back to work any day. That simply is not realistic any more.

Today we are going to explore a number of questions about the direction and purpose of the unemployment insurance program. Can it be made more responsive to the needs of unemployed workers as we find them today? Can its income support function be made more efficient? Are there ways the funds could be used in a positive way to get unemployed workers back to steady employment?

I'm looking forward to beginning what I hope will be a continuing dialog on these important issues in the 100th Congress.

Mr. Chairman, I would particularly like to welcome our colleague, Bill Clinger, who has served long and assiduously with me as cochairman of the Task Force of the Northeast-Midwest Coalition on Unemployment Insurance. And I know that his message this morning will be a brilliant one.

Welcome, Bill.

Acting Chairman DOWNEY. Thank you, Don.

The subcommittee wants to recognize the fine work you've done. We would not be here except for your hard work and leadership on this matter.

STATEMENT OF HON. WILLIAM F. CLINGER, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. CLINGER. Thank you very much, Mr. Chairman and members of the subcommittee.

I'm pleased to have the opportunity to testify before you this morning and specifically to testify on the bill which Congressman Don Pease and I introduced ea ier this year—the Extended Unemployment Insurance Reform Act of 1987.

This legislation is designed to turn the unemployment insurance system from a passive income maintenance program into a positive strategy for worker-adjustment assistance with training, entrepreneurial opportunities, and improved counseling, testing, and job research services.

This legislation really grows out of a report and a study which was done by the Northeast-Midwest Coalition some time ago and which was put out back in April. And we'd be happy if that might be included in the record, Mr. Chairman.

Acting Chairman DOWNEY. Without objection, the Northeast-Midwest Coalition study will be accepted.

Mr. CLINGER. Thank you, Mr. Chairman.

As Congressman Pease has said, you might wonder why we would be considering unemployment—reform in the unemployment compensation system at a time when the unemployment rates are not a threat, not a worry.

But I think, as Congressman Pease has pointed out, there is really good reason for us to be taking a look at this in a nonpressurized environment where we are not under the gun to do something hastily and perhaps regret it at leisure.

Second, as he has pointed out, the system as it presently exists is really increasingly anachronistic. The fact is that it just does not address the needs that exist out there, because we now have structural unemployment.

This system was designed to really meet very short-term unemployment. And increasingly, it just does not address the needs of workers who find themselves on the streets for long periods of time.

The Pease-Clinger bill, Mr. Chairman, makes specific reforms in the unemployment insurance system that would first restructure the extended benefits program's current 13-week all-or-nothing approach into a flexible support for UI exhaustees with benefits varying from 10 to 30 weeks, depending upon the State's unemployment rate.

Second, it would say that Federal financial participation would be on a sliding scale. Presently the system, as you are aware, is a 50/50 matching rate.

This tends to really penalize States that have the worst problems. In other words, the higher and the longer your unemployment rate goes on, the more it's costing you, when in fact some of the problems are not of your making, but you have to pay a higher premium to address the problem.

The bill would allow a State to use its total unemployment rate. Presently, you determine whether you are on or off extended benefits, as you are aware, Mr. Chairman, by the insured unemployment rate, which is often very misleading.

It also provides for a demonstration of the feasibility of using substate triggers in place of the current whole-State trigger to activate the EB program in areas of high and prolonged unemployment.

Another feature of this bill would be to provide a demonstration of financial incentives for the State to enroll more UI recipients in training so that the unemployed can use idle time productively to learn new skills for new jobs.

Again, the present system really does not relate to training opportunities at all. It is totally silent on that whole, vast area.

And that really is what we think is the major reform here—is that we are linking the unemployment compensation system to expanded opportunities for training.

Third, it provides for a demonstration of the feasibility of allowing the unemployed to start their own businesses, using their UI entitled as an upfront lump sum investment or as a weekly income supplement while the businesses get on their feet.

This is a concept that has been used successfully in some foreign countries. Britain, France, and Belgium have all instituted this idea of encouraging entrepreneurial activity.

As we know from books like Megatrends and others, there is increasing emphasis on small, startup businesses—specialized types of businesses. We think that this program should give at least an opportunity to try out some of these ideas.

Now, it's not an open door. We're going to obviously have to have some restraints on the kinds of activity that you would authorize. But we think it has real merit and should be tried, and this bill would provide for a demonstration in five States in the country.

Finally, it increases the amount of future revenues devoted to employment-service testing, assessment, and counseling to guide the unemployed to appropriate jobs or retraining opportunities.

Clearly, the present unemployment insurance system penalizes the long-term unemployed. And we do not know—nor can we predict—what the next economic cycle will bring. What we do know is that unemployment and outmoded worker skills are problems not solely confined to the rust belt—which Congressman Pease and I and you, Mr. Chairman, and Mr. Frenzel represent—but to the Nation as a whole.

I'm especially pleased that the legislation would establish a demonstration project providing for sub-State pockets of unemployment to qualify independently for extended unemployment benefits and special consideration in worker-retraining programs. Again, this would call for demonstrations to be established in five States in the Nation, to be selected by virtue of where they do have these pockets of poverty.

Also, in order to qualify for this program you would have to have 1 percent above what normally would trigger you on to the extended benefits, so it's not going to be something that is going to be easy to get. In fact, it should be devoted only to the most severely distressed areas.

But I know in my case in my State—and I know in Congressman Pease's—the State as a whole may not qualify to trigger on an extended benefit, but there are substantial areas within that State that are very, very impacted—heavily impacted—and really deserve to have consideration, even though the State may not qualify.

So in closing, I would just like to recognize and thank those that I have indicated—the Northeast-Midwest Institute, who have worked so diligently to provide recommendations to battle unemployment in our region and the Nation.

And I would also want to commend and congratulate my cochairman and my chairman of the Task Force on Unemployment Compensation and Insurance, Don Pease, who has just been a real warrior in this whole fight.

And thank you very much, Mr. Chairman.

[The statement of Representative Clinger and an attachment follow:]

Congressman William F. Clinger, Jr.
December 14, 1987
Testimony before the Committee on Ways and Means'
Subcommittee on Public Assistance and
Unemployment Compensation

Mr. Chairman and members of the Subcommittee, I am pleased to have the opportunity to testify before you this morning.

On June 11, 1987, Representative Don Pease (D-Ohio) and I introduced the Extended Unemployment Insurance Reform Act of 1987, H.R. 2676. This legislation is designed to turn the Unemployment Insurance (UI) system from a passive income maintenance program into a positive strategy for worker adjustment assistance with training, entreprenunial opportunities, and improved counseling, testing, and job research services.

I know some will say why be concerned about making changes in the UI program when the nation's civilian unemployment rate is at a decade low 5.9 percent. However, I submit that this is exactly the right time to make UI more reliable, more responsive and more effective. We should take advantage of this opportunity to make the kind of thorough and thoughtful revision of the extended compensation system which will leave us prepared for whatever economic eventuality we might face in future years, instead of patching up the system whenever an emergency presents itself.

The Pease/Clinger bill makes specific reforms in the unemployment insurance system that would:

* restructure the Extended Benefits program's's current 13 week "all or nothing" approach into a flexible support for UI exhaustees, with benefits varying from 10 to 30 weeks depending on the state's unemployment rate. Federal financial participation would be on a sliding scale, replacing the current 50-50 matching rate. The bill would allow a state to use its total unemployment rate (TUR) to determine EB eligibility and benefits. It also provides for a demonstration of the feasibility of using substate triggers in place of the current whole-state trigger to activate the EB program in areas of high and prolonged unemployment.

* provides for a demonstration of financial incentives for the state to enroll more UI recipients in training so that the unemployed can use idle time productively to learn new skills for new jobs.

* provides for a demonstration of the feasibility of allowing the unemployed to state their own businesses using their UI entitlement as an up front lump-sum investment or as a weekly income supplement while the business get on its feet.

* increases the amount of FUTA revenues devoted to Employment Service testing, assessment, and counseling to guide the unemployed to appropriate jobs or retraining opportunities.

Clearly, the present unemployment insurance system penalizes the long term unemployed and we do not know -- nor can we predict -- what the next economic cycle will bring. What we do know is that unemployment and outmoded worker skills are problems not solely confined to the Rust Belt, but are national in scope.

The Pease/Clinger bill adds flexibility to the Extended Benefits (EB) program allowing it to target compensation and adapt to the reality of unemployment.

I'm especially pleased that the legislation would establish a demonstration project providing for substate areas of "pockets of unemployment" to qualify independently for extended unemployment benefits and special consideration in worker retraining programs.

My state of Pennsylvania is a good example of the need for this flexibility. While the state unemployment rate is below the national average, areas in the western portion have been extremely hard hit by the decline in steel, coal and related industries. We simply cannot go by state averages and say all is well. We must give those distressed communities a fighting chance by retraining our workforce to meet the demand of a changing industrial base. If it sounds daunting -- it is. But I feel our legislation offers some real alternatives and I look forward to input from those like yourselves who take the time to reflect on this serious problem.

In closing, I would like to recognize and thank those at the Northeast-Midwest Institute who have worked diligently to provide recommendations to battle unemployment in our region and the nation. And finally I would like to recognize my colleague, Don Pease, who has been a champion of ideas in this and many other areas.

Again, thank you for the opportunity to be here today.

Reemploying UI

Unemployment Insurance, Training, and Job Creation

Paula Duggan
Charles Bartsch

Northeast-Midwest Institute:
The Center for Regional Policy

Education-Economic Development Series

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Preface

Unemployment insurance (UI) was designed to be a short-term income maintenance program. As such, it works well. However, unemployment in the United States is more complex now than even a few years ago. Structural dislocation, a type of unemployment in which long-term employees lose their jobs permanently, is becoming more prevalent.

Technological change and increased international competition have left thousands of closed plants and millions of workers with obsolete skills. Unemployment among these dislocated workers persists even in periods of economic recovery. They need to upgrade basic skills, learn new occupations, and move on to different employment, instead of waiting in vain for a call back to old jobs. To deal with this newer variety of unemployment, UI must become a mechanism for helping people adjust to change. It cannot remain a "holding vat."

Educational institutions have a real stake in this issue. Community colleges, vocational-technical schools, four-year colleges and universities, and other providers offer remedial education and occupational training that unemployed workers need. They provide career counseling, teach job-search skills, and instruct people in how to start their own businesses and create their own jobs. They also play a vital role in helping people and communities make positive adjustments to economic change.

Postsecondary schools are recasting their traditional services to reach new constituencies, including older students, people wanting to improve or change jobs and careers, and budding entrepreneurs. Dislocated workers form a large pool of potential clients who might enroll in occupational or entrepreneurial training, or take advantage of other business-oriented services. They should be encouraged to do so by a "change-oriented" rather than "income maintenance only" unemployment insurance program.

The Northeast and Midwest have a vital interest in making this shift happen. The region has a disproportionately large share of the nation's dislocated workers and long-term unemployed. It continues to undergo an economic transformation, creating different skill needs for which workers must prepare through education and training. At the same time, a tradition of good schooling has given the region's economy a competitive advantage. The region has benefited from high levels of public investment in both K-12 and postsecondary education. The return on this investment can grow if UI recipients have greater access to schools' resources.

This is the fifth volume of a six-monograph series designed to promote stronger ties between the region's educational resources and the economic development process. Focusing on a single critical issue, each monograph is designed as a tool for public policy makers and their counterparts in business and academic institu-

tions to translate available ideas into pragmatic solutions. The series explores strategies that touch all educational levels from local K-12 public school systems to higher education.

This education-economic development series is made possible through the generous support of the American Can Company Foundation.

1. Unemployment Insurance: Bridge or Ladder?

Unemployment insurance is the country's primary line of defense against disruptions to persons and communities caused by unemployment. The system was created by Congress in 1935 as part of the Social Security Act. It has cushioned the impact of recessions by providing temporary income to see workers through short spells of joblessness. The communities in which they live are helped as well, because UI payments maintain purchasing power and tax bases. Companies forced to lay off employees also benefit—their workers can stay in the community and wait for recall when economic conditions improve.

By law, UI revenues may be used *only* to pay benefits. The source of financing for UI, a dedicated tax on employers' payrolls, underscores its role as a temporary income-support program. Today most states assess the UI tax on the first $7,000 of each employee's wages. Federal and state governments cooperate in the administration of this financing mechanism. Within broad federal guidelines, states set their own tax rates, decide on the duration and amounts of benefits, and determine individuals' eligibility to receive payments. The state UI programs generally provide benefits for up to 26 weeks to persons who are laid off through no fault of their own and are available and looking for work.

Employers' state UI taxes are deposited in state accounts with the federal treasury. These taxes are offset against an employer's tax liability under the Federal Unemployment Tax Act, commonly called FUTA taxes. Employers' FUTA taxes cover the costs of administering the UI system nationwide, pay the federal share of additional benefit programs beyond regular state UI, make loans to states whose account balances are insufficient to cover UI payment obligations, and finance the Employment Service.

In theory, state UI trust funds build up reserves during periods of economic growth that are then available for payout during economic slumps. Three recessions in the last decade, however, pushed several state systems to the edge of bankruptcy and dramatized the importance of maintaining financial stability in the UI program. Over half the states were forced to borrow from federal funds to cover benefit entitlements. In 1983, state UI accounts were approximately $13 billion in debt to the federal treasury.

States have reduced their UI debts substantially in recent years by cutting benefits and raising tax rates to achieve greater solvency in their systems. At present some UI accounts have surpluses. However, the "debt crisis" shows how the changing nature of unemployment has rendered a temporary-income solution inappropriate for many of the jobless. Dislocated workers often remain unemployed for the duration of their 26-week UI eligibility and well beyond. This happened to hundreds of thousands of workers in the

recessions of the 1970s and 1980s, and was at least partially responsible for the UI debt in many states.

New Kind of Unemployment

Between 1979 and 1984, 11.5 million workers 20 years of age and over lost jobs because of plant closings or employment cutbacks. Of these, 5.1 million had held their jobs for at least three years, thus building up substantial histories with their employers. In a special study published in July 1985, the Bureau of Labor Statistics (BLS) identified these people as dislocated workers.[1]

Many dislocated workers are in the middle years of their working lives; often they are the primary wage earners for their families. Most went to work directly from high school, sometimes before graduating, for a manufacturing firm where they expected to stay until retirement. Frequently they had the same occupation for as long as 20 or 30 years and have endured previous layoffs by waiting them out. They have not looked for work in years, and never anticipated having to do so. Now, however, they find themselves without jobs, but with many of their prime working years still ahead.

Senator Dan Quayle (R-Indiana) described their situation well in a speech on the Senate floor:

> . . . a dislocated worker has previously established a strong attachment to the labor force. Over many years, this person has developed a good work history in his job or occupation. This demonstrates independence and personal initiative. This is a major difference between the new structural unemployment problem and that with which we have dealt in the past.[2]

Dislocated workers draw unemployment insurance benefits when their jobs disappear as if they were on short-term layoffs. However, dislocated workers have characteristics that call into question the usefulness of the UI program in getting them back to work. Obviously, when a plant closes or a mass layoff occurs, some of the unemployed find new jobs quickly. Others need some help—assessment of their skills, occupational counseling, a refresher briefing on job-search skills, resume writing, and interviewing techniques—plus UI income while they look for work. The Employment Service (financed by the FUTA tax), provides some of this needed help with job-searching. But dislocated workers often require much greater levels of assistance, such as remedial education and training in new skills, before they can be reemployed.

The BLS special study also contained new information on the reemployment patterns of dislocated workers. Of the 5.1 million dislocated workers, about 3.5 million received unemployment insurance benefits at some point in the five-year period covered by the study. Nearly half had exhausted their benefits—they were unemployed long enough that their eligibility for UI expired. In January 1984, over 1 million dislocated workers were unemployed; over half of those still looking for work no longer received UI benefits. Another 481,000 workers had given up looking and dropped out of the labor force; of these, 327,000 had exhausted their UI benefits before giving up.

The BLS study found that 2.8 million dislocated workers had found jobs as of January 1984.

About half were earning as much or more than they had previously. However, 900,000 had taken some pay cuts, and 600,000 had sustained an earnings loss of 20 percent or more. Many of the reemployed were working in occupations and industries different than their original employment. The highly skilled workers were more likely to be reemployed. Although the BLS study does not provide statistics on this issue, many dislocated workers probably had to learn new skills to find new jobs.

While BLS found dislocated workers in all parts of the country, a particularly large number—1.2 million—lived in the East North Central area, which includes the heavily industrialized states of the Midwest. Another large concentration of 800,000 dislocated workers resided in the Mid-Atlantic states—New Jersey, New York, and Pennsylvania.[3]

The heaviest incidence of structural dislocation is in the Northeast and Midwest, which have 57 percent of dislocated workers still unemployed.[4] This region has a very large stake in the interconnected issues of UI income support, occupational retraining, reemployment, and new job creation.

Employers and UI

Employers have a large interest in the UI system because their taxes finance it. Employers' tax rates are partially "experience-based"; in theory, this means that employers having frequent or prolonged layoffs are taxed at a higher rate than those maintaining more stability. In fact, "experience-rating," as this disincentive is called, works imperfectly; as a result, UI costs are partially "socialized" across all employers.

While individual employers may want UI to support the company's work force subject to recall, employers in general want people reemployed as soon as possible. Few employers see their best interests served in paying benefits to workers whose plants have shut down or who have no prospect of returning to their former employment, and in paying those benefits to the "exhaustion" point (generally 26 weeks).

The desire to get people back to work quickly led to the requirement that UI recipients be "available and looking for work." This "UI work test" is intended to ensure that the unemployed make every effort to find new jobs. Eligibility for UI can be terminated if the recipient refuses an offer of "suitable work," usually defined by a wage level comparable to that of the recipient's prior employment. A recipient also becomes ineligible if he starts his own business because he no longer meets the test of searching for work.

But what if no jobs are available, or, more likely, no jobs the person is qualified for? The most commmon barrier to reemployment is the lack of jobs that pay wages adequate to cover workers' financial obligations, such as home and family, built up over many years of steady employment with a now defunct company or plant.

For employers as a whole, what matters is that recipients land jobs and get off UI. They have no interest what wage the jobs pay the employees. With UI taxes generally assessed only on the first $7,000, most employers do not see an obvious payoff in supporting retraining for the unemployed even though it might qualify them for appropriate or suitable wage jobs. In fact, many employers see a downside to training: it takes

time and may prolong the person's receipt of UI. However, education and training may be just what dislocated workers need.

Another option for dislocated workers might be starting a small business. Occupational skills they gained in previous jobs could be the basis for a service firm, or a hobby might have potential for product development and sales. With the right advice and support, the dislocated worker might create his own way out of unemployment. This approach is not without its critics, however. Some in the business community object to allowing a person to try this avenue while collecting UI, because employer taxes would be helping to finance potential competition.[5]

For employers, UI policy choices are somewhat akin to tossing a coin: the bet is on whether unemployed workers will get off UI faster and more permanently by looking for the same work, or by another route, such as updating skills, learning other skills for a different occupation, or starting a new business.

Clearly, however, the UI system involves more than the interests of employers whose taxes finance it; workers whose livelihoods are at risk and society at large have a stake in the systems as well. A few states require employee contributions to UI—a policy that recognizes workers as interested parties. Some would argue that ultimately all UI taxes are paid by workers in the form of lower wages. From this perspective, workers' interests would be the primary concern for policy making on UI.

In contrast to the U.S., some European countries use general revenues to pay unemployment benefits, on the theory that society at large suffers when unemployment rises. In the U.S., the question of whose interests are foremost becomes problematic when unemployment rises and becomes prolonged. The belief that societal interests are involved led to other measures to help the unemployed through these periods. The federal government set up the Extended Benefits program that provides 13 weeks of benefits past the original 26 in states where unemployment levels have passed a "trigger" point.

The federal government and the states share the cost of this program. In the recessions of the 1970s and 1980s, the federal government instituted supplementary tiers of unemployment benefits financed by general revenues, which also fund assistance for particular categories of workers, such as those whose jobs disappear because of foreign trade pressures. In short, these policies recognize that at some point long-term unemployment becomes a larger concern, not limited to the employer community.

The question for public policy makers in addressing structural dislocation and long-term unemployment is whether to continue only to support those unemployed or to institute new policies to get them reemployed. The next two chapters explore ways that public and private-sector leaders can help to turn unemployment insurance from a passive income-maintenance program into an active tool for economic adjustment. The discussion includes recommendations on how educational institutions as well as federal and state policy makers can participate in this new adjustment approach and contribute to the self-sufficiency of individuals and the economic health of their communities.

2. Training

Training is the key to reemployment for many of those out of jobs. Workers must be flexible and adaptable, ready to learn new skills, and open to the prospect of retraining to meet workplace needs. The growth of the service sector relative to manufacturing has increased the demand for higher-level analytical and reasoning skills. Similarly, in manufacturing, the changing skill content of jobs and the move to more participatory forms of management require workers to think critically and apply knowledge to a greater degree than in the past.

Some workers facing the prospect of long-term unemployment can benefit from immediate retraining. Some find it through training offered by new employers on the job. Others gain new skills by returning to school.

Educational institutions, particularly community colleges and vocational-technical schools, have experience in the training field. Most offer courses in a variety of occupations. Frequently, they set up training programs under contract for companies wanting courses tailored to their specific needs. They also provide training for clients of public programs, such as welfare or the Job Training Partnership Act (JTPA).

Other workers require help with basic education before they can begin training for new occupations. Employers, unions, training program operators, and educational institutions have found that many dislocated workers seeking retraining lack the basic skills needed for their courses. One assistance center, Downriver Community Conference in Southgate, Michigan, estimates that 30 percent of its dislocated worker participants read at or below the sixth-grade level and need remedial education before they can be retrained. Other dislocated worker programs report similar findings.[6]

Educational institutions also conduct remedial courses in basic skills: reading, writing, and mathematics. Remedial instruction often is integrated into skill training so that students can see the relevance of basic education for their future work.

Remedial education and occupational skill training have been the route out of unemployment and dependency for hundreds of thousands of people. Educational institutions have a record of success that holds promise for UI recipients. For them to have access assured to these resources, however, federal and state policy makers must make some changes in the UI program.

Approving Training for UI Recipients

Congress has recognized that training can be valuable in the reemployment of UI recipients. In 1970 it amended the UI statute to prohibit states from denying UI eligibility to persons who are in "training with the approval of the state." In essence this provision waives the UI requirement that recipients, for the duration of

training, be "available and looking for work." Congress has reaffirmed several times its support for combining UI and training, most recently when it passed the Job Training Partnership Act in 1982; the law states that all training conducted under Title III, the dislocated workers' program, is to be considered "training with the approval of the state."

State agencies differ, however, in their administration of these provisions to encourage training. While all states approve JTPA Title III programs, many have cumbersome procedures for approving other programs or for allowing UI recipients not eligible for Title III to enroll in job-related educational programs.

These difficulties are due in part to the complexity of state approval processes. State agencies must determine what training programs or courses are approved, and which persons are approved. State Employment Security agencies are entrusted with this approval process. Few, however, have any particular expertise in deciding what training should be approved. Presumably, questions of the quality and relevance of instruction must come into consideration—questions familiar to state education agencies and accrediting boards, but not so routine for Employment Security personnel.

Some members of Congress have introduced legislation that would require governors to designate an agency to approve training. This would allow governors to choose the agency best equipped to make determinations about the quality of training. Short of congressional action, **governors should review which agency in the state is handling the approval process for UI training programs. They should assign this function to the most appropriate body.**

Massachusetts has dealt with this part of the approval process by giving automatic approval to courses funded under a variety of employment-related programs, including JTPA Title IIA (training for the disadvantaged), Adult Basic Education (ABE), English as a second language (ESL), GED preparation, Bay State Skills Corporation, and other Massachusetts-specific programs. Other courses must meet the following criteria:

- be conducted on a full-time basis—20 hours per week;
- consist of vocational or industrial training;
- provide intensive training of short duration (1 year or less);
- be designed not primarily to meet the requirements of a degree program; and
- achieve an average "placement rate" of 70 percent during the most recent 12-month period for which such data are available.[7]

Local UI office claims adjudicators have the responsibility for making determinations in the course-approval process.

All states should specify which programs and/or institutions are approved automatically for providing training to UI recipients and should develop clear criteria for prompt approval of additional training programs. Educational administrators should find out if their programs are approved for training UI recipients, and seek approval if it is not granted automatically.

The second part of the approval process deals with a determination of which individuals should be approved to enroll in training.

Here, the practical problem in administration is not only whether training will help a person's reemployment prospects but also whether enrollment in a training program will prolong an individual's receipt of UI benefits. Some evidence from the state of California indicates that participation of unemployed workers in training while receiving UI may increase the duration of benefits, and thus increase UI costs.[8]

Massachusetts specifies who may be approved quite strictly because the state will pay additional UI benefits past the 26-week regular program while a person is in attendance at the training facility. The total of these additional benefits may not exceed 18 times the weekly UI benefit amount to which the person was entitled. Automatic approval is granted to JTPA Title IIA participants, those who meet state definitions of "dislocated worker," and "long-term claimants who have been in total unemployment for 15 consecutive weeks or longer and have been permanently separated from their last employer."[9] For individuals who do not qualify for automatic approval, the state has an application process.

The option of enrolling in training while collecting UI is advertised widely to claimants. The Division of Employment Security's policy states: "This opportunity to obtain training and education while unemployed is to be brought to the attention of all claimants. Claimants are to be encouraged and assisted in their consideration of the training option."[10]

All states should adopt clear policies on who may enroll in training while continuing to receive UI and make these determinations promptly in each case. State policies should encourage training for UI claimants who will have difficulty finding new jobs without improved skills.

The Massachusetts criteria for long-term claimants (15 weeks unemployed and permanently separated from an employer) suggest that states can develop objective measures to define automatic eligibility in a way that limits additional costs to the UI system while claimants enroll in training. States already use UI data to study broad questions of occupational growth and decline; these data also could be used to help make determinations of individuals' reemployment prospects and the potential benefits of retraining.

States should study historical UI data to see whether patterns of UI exhaustion exist in particular occupations and industries. New UI claimants from these sectors could be made eligible for retraining automatically.

State Employment Service agencies sometimes administer aptitude tests for UI recipients. They could make these assessments in conjunction with administering the UI work availability test. Using various tests, Employment Service job counselors could judge whether an applicant's basic skills are adequate for the literacy demands of today's jobs. The counselor also could determine if a person's job skills might be suitable for an entirely different occupation. This process might open up possibilities for placing the person in immediate new employment. It also might indicate that a person's skills are so specific to an obsolete job that retraining is the best route to reemployment.

States should use assessment of the UI recipient's existing skills to help decide if retraining would be useful.

Federal budget reductions for the Employment Service in the early 1980s led states to cut back drastically on testing and assessment activities. As a result, the number of individuals receiving ES counseling dropped by 40 percent between 1981 and 1983, and the number tested declined by 30 percent. However, accurate assessment is essential to the efficient use of UI and limited training funds available under the Job Training Partnership Act. **States should reexamine their use of Employment Service funds and reemphasize testing and assessment to conserve scarce income-support and training dollars.**

In 1982, Congress passed amendments to the Wagner-Peyser Act (the authorizing legislation for the Employment Service) returning a substantial amount of discretion to the states to set their own ES priorities. The amendments also changed the ES planning process to give local Private Industry Councils a say in how ES funds could be used best in conjunction with job-training funds. The legislation directed that each state dedicate ten percent of its funds to improving performance, including providing services to groups with special needs.

The 10 percent setaside should be used to strengthen the assessment and testing capacity of the Employment Service and to improve the process of determining whether UI recipients would benefit from retraining. Private Industry Councils should emphasize this activity in their consideration of ES plans for local service.

The UI-retraining connection is significant for the providers of skills programs—community colleges, vocational-technical schools, four-year institutions, and others—because it bears on recipients' means for supporting themselves while in training. The Job Training Partnership Act offers scant help; it places emphasis on training rather than income support, and prohibits the payment of allowances, stipends, or wages. Many program operators cite this absence of funds for basic support as an impediment to training. Under JTPA's predecessor, the Comprehensive Employment and Training Act (CETA), a large percentage of funds went to providing stipends for persons enrolled in various educational and training activities. JTPA's ban on support payments, however, has forced training providers to make alliances with existing income maintenance systems, such as welfare and UI, to help trainees in their programs.

Educational institutions clearly have made the necessary connections. Community colleges and vocational-technical schools are major providers of training for JTPA's dislocated workers program (Title III). However, school administrators should look beyond JTPA and make their services available for other UI recipients.

Educational administrators should talk with state Employment Security administrators to determine what policies the state has adopted for increasing the enrollment of UI claimants in training and educational programs. They should emphasize the logic of training people while they have some income to support themselves.

The Employment Security system, composed of UI and the Employment Service, is a federal-state partnership. The federal gov-

ernment has a responsibility for promoting the best practices in this system, including the option of training, if they lead to the reemployment of UI recipients. Despite its 1970 congressional prohibition on denial of UI eligibility to persons in training, the federal government has given the states little help in sorting out the components of "approval" or assessing the costs and benefits of training.

The Department of Labor should provide technical assistance on the training issue to the states, helping them to share information about processes for approving training for UI recipients.

In particular, the Department should develop optional methodologies for using historical data and assessment tools to help states anticipate who may exhaust UI and who may benefit from retraining.

The Department of Labor also can upgrade and expand existing data collection systems to gather and publish better information on training activities. The Department currently collects only limited information about participants in the JTPA programs for dislocated workers. States are required to report whether participants were receiving UI at the time of enrollment and whether they were long-term unemployed. The reporting system could be expanded to offer more insight on the issue of costs and benefits of training UI recipients.

The Department of Labor should include information in the JTPA reporting system on the number of weeks of UI received by Title III trainees, and data on their exhaustion of UI benefits before or during participation in Title III. The Department also should collect information about the training experiences of non-JTPA UI recipients, including data on occupations and wages before and after training, to evaluate its contribution to their reemployment.

Congress can take other steps to encourage states to use training as an option for UI recipients. For example, states are allowed to count UI payments made to dislocated workers in training programs (Title III) as part of the required state match for federal funds. This precedent could be expanded to other required state spending.

Since the potential of training to extend the duration of UI benefits causes concern about UI debt, Congress could offer an incentive to states by allowing them to offset UI payments made to training-program participants against interest owed on loans to cover UI obligations. It could allow other offset-type encouragements for states with no outstanding loans.

Congress should develop positive incentives for states to combine UI and training using the offset precedent of Title III of JTPA.

Congress also could "approve" of more training than JTPA Title III. For instance, although few UI recipients are eligible for JTPA Title IIA because of its income restrictions, granting blanket approval to these programs could set an example for states on how to establish automatically what is "approved." Some training programs for veterans also might be treated this way.

Congress should explore whether additional federal training programs could be considered "training with the approval of the state."

Work Sharing

Work-sharing is an innovation in the UI system adopted by several states. Also called part-time compensation, the program provides partial UI payments to workers to compensate for reduced work hours. It serves as an alternative to layoffs when an employer faces slack demand. Rather than laying off 20 percent of a firm's work force, for example, the company could ask employees to work four days a week and receive unemployment payments as partial compensation for the fifth day's wages. The program helps employers by allowing them to retain a skilled work force; it also helps the employees, who share the hardship of unemployment but keep their jobs.

Work-sharing has the subsidiary effect of giving workers time to upgrade their skills or train for new occupations where permanent work force reductions are inevitable. On their day off, workers might enroll in courses at a community college or vocational-technical school. Since people on work-sharing have jobs already, the regular UI rules about "available and looking for work" do not apply. Therefore, state approval for training is unnecessary.

Institution of a work-sharing policy in the UI system requires state legislation. California has run such a program for several years. Arizona, Oregon, Washington, Florida, and Maryland have authorized its operation, and others are considering it. As with training UI recipients, work-sharing may increase costs to the state's UI program. In California, the program has a small negative financial impact on state government revenues. Each state would have to analyze potential costs against benefits in work-sharing programs.[11] Where permanent layoffs are anticipated, the program does give workers lead time to prepare for new employment opportunities.

Administrators of education and training programs should find out if work-sharing is authorized in their state. They can work with Employment Security administrators to determine whether training would be a useful option in particular work-sharing situations.

State-Initiated Training Funds

Federal law limits the use of UI funds solely to the provision of benefit payments. Congress could change the law to allow FUTA tax revenues to fund training directly. Recognizing that such action is unlikely in the near future, states are creating funds for training that use the UI tax-gathering capacity in new ways. As discussed, various factors have kept the combination of UI and training from flourishing. However, a general lack of funds to support training also has slowed progress. JTPA Title III is the only readily available financing, but funds for this program nationwide will amount to $200 million for fiscal 1987. At this level, the program probably serves only about 4 percent of those eligible.

States increasingly are recognizing the value of training to make their economies competitive. A skilled work force is a prime asset for businesses seeking to expand or relocate. States used the opportunity presented by Title III to enlist their educational institutions in helping dislocated workers. They quickly engaged their community college and vocational-technical systems to provide remedial education, skills

upgrading, and occupational retraining for those with small chances for reemployment. Now, states are developing innovative ways to fund more training and put their entire educational systems to work for the unemployed.

In 1982, the California UI system had a $2.7 billion surplus. The legislature reduced the overall UI tax rate by 0.1 percent and instituted the Employment Training Tax on employers at the same level. The tax supports programs to help people in the work force learn skills that either put them back to work or keep them from losing their jobs. Thus, workers are eligible for training if they are UI claimants, likely to become claimants, or have exhausted their benefits. About 2 million California workers were eligible in 1982. The new tax can generate $55 million per year for training. Collections in excess of the $55 million limit revert to the state's UI fund.

The California fund is administered by the Employment Training Panel. It relies on the state's extensive community college network to develop programs that meet the needs of specific companies or provide skills in occupations in demand. The community colleges and the state strive to ensure that all training will lead directly to jobs. Colleges are allowed to train workers only for jobs that promise long-term security and reasonable wages. Training does not begin until employers agree to participate and hire those completing these programs.

In addition to the primary mission of training the unemployed, the California legislature wanted the training panel to support two related economic development goals: giving employers an incentive to locate or expand their companies, and improving the business climate by reducing employers' UI costs in the long run. As newly trained persons secure steady employment, all employers are expected to benefit.

A state-owned training fund has the advantage of allowing the state to set its own eligibility rules and establish its own priorities for training participants. Because California's program is an offshoot of the UI system, UI recipients are primary choices for service. **States with UI systems generating healthy surpluses should consider lowering their UI tax rates and substituting an equivalent tax to create a training fund.**

Delaware recently established a Permanent Training Fund by substituting a training tax for a UI-related tax. A unique opportunity arose when the state's 0.6 percent FUTA penalty tax expired in 1984. (The federal government imposed this penalty tax on all states to pay off the debt created by the Extended Benefits program in past recessions.) Delaware's legislature continued to collect 0.1 percent after 1984 to create the training fund. The new tax represented a lowered burden for employers while generating a 32 percent increase in training funds for the state. Funds collected are used for any of the following activities:

- counseling, training, and placement of dislocated workers;
- providing industrial training; and
- assisting with vocational guidance, training, and job development.[12]

The FUTA penalty tax that allowed Delaware to create its training fund expires at a different time in each state as its purpose is completed.

States should retain portions of expiring FUTA penalty

taxes to create new training funds.

The Massachusetts legislature is considering a major package of legislation to tie several education, employment, and related activities into a comprehensive, labor market-based training delivery system. The state already has redrawn its employment security system's service boundaries so that UI and Employment Service operations correspond geographically to the JTPA service delivery system.

The legislature is considering the creation of a state training fund supported by a small excise tax on employers. This 0.1 percent tax on the first $7,000 of every employee's wages (the same base used for the UI tax) would go into a "skills investment fund" used for skills upgrading, training and retraining, and adult literacy programs.

The bill before the legislature envisions that 25 percent of agencies targeting their services to UI recipients, exhaustees, persons about to be laid off, and dislocated workers would receive training contracts.

These state initiatives highlight the efficiency of the UI tax-gathering system and its effectiveness in generating large amounts of revenue. Obviously, its coverage declines during recessions when the payroll base for the tax shrinks and claims for UI grow. All systems must accumulate substantial surpluses to guard against insolvency during economic slowdowns. States also must be zealous in guarding the financial stability of their programs.

However, while unemployment increases the need for temporary UI income, it also makes imperative the need for retraining workers whose jobs will be lost permanently. These state training funds can be a significant factor, perhaps more effective than UI in the long run, in helping workers into more secure employment futures. Quality training, provided through the state's networks of two-year colleges and technical schools, will show profits for individual workers and state economies after temporary income has run out.

Educational administrators obviously are concerned about financial resources to operate training programs. They are called upon to speak publicly about the adequacy of budgets for this purpose. **Educational administrators should work with Employment Security administrators to examine the feasibility of creating state training funds based on payroll taxes. They could become important allies in presenting this concept to the legislature.**

3. Using UI to Promote Self- Employment

Congress and the states have allowed the UI system, in limited circumstances, to support workers in training programs. States are setting up training funds using innovative taxing schemes.

Another course of action taps the potential of UI for creating new jobs: helping people to start their own businesses while collecting UI. Use of public money to underwrite private enterprise usually is reserved for large undertakings; the mechanism, however, can work well for the individual entrepreneur.

Self-employment is growing faster than salaried employment. Its growth accelerated following recent economic swings as some of the unemployed became "entrepreneurs of necessity." Independent small businesses are important contributors to local economies because they often create job opportunities for others. During the 1980-82 recession, small firms with fewer than 20 employees produced a total of 2.6 million new jobs, more than offsetting the 1.7 million positions lost by large businesses.

Starting a new business requires capital investment. The amount varies from enterprise to enterprise, but often it is smaller than people realize. A recent survey of 155 new firms by the National Federation of Independent Businesses showed that 18 percent had started with less than $5,000 in capital, another 13 percent with $5,000 to $10,000 and nearly half had begun with less than $20,000.[13] Start-up investment money usually is in short supply for the unemployed, however. Workers' unemployment insurance could go a long way toward meeting these capital needs.

The amount of UI paid per week depends on the person's wages over several previous quarters. In mid-1986 the average weekly UI benefit nationwide was over $129. This ranged from $89.52 in Mississippi to $155.60 in Minnesota. Assuming that a person collects UI for a full 26 weeks, UI provides sums ranging from $2,328 to $4,046. Budding entrepreneurs could use this money to finance part of their start-up costs.

European Self-Employment Programs

The United States has no experience in using UI to promote entrepreneurship and new business creation. Several European countries, however, have launched programs to help the long-term unemployed create jobs for themselves by founding their own firms. Foreign program designs include loans or grants, lump-sum payments, and periodic installments. Some require personal capital and formal business plans, but others do not.

Great Britain and France have had programs in place for several years, and report encouraging results. The British estimate that for each 100 participants in its Enterprise Allowance Scheme (EAS), unemployment falls by 33 persons. France attributes one-third of all business starts in the

past three years to its self-employment program.[14] These programs involve between 2 and 3 percent of the unemployed in these countries annually.[15] Both suggest options for experiments in the U.S. to test the feasibility of using UI to create jobs through small business start-ups. In fact, the first of these, the Self-Employment Investment Demonstration, will get under way in 1987. This four-year project sponsored by the Corporation for Enterprise Development will promote self-employment as an option in welfare-to-work programs in seven states in the Northeast-Midwest region.

The British Enterprise Allowance Scheme helps those unemployed 13 weeks or longer start businesses by paying them a flat allowance of 40 pounds (about $60) a week for a year in place of their regular unemployment benefits. Prospective entrepreneurs must have at least 1,000 pounds (approximately $1,500) of their own money available to invest in their businesses. Applications are not screened for the viability of the business proposal or likelihood of success. However, applicants must attend an introductory training session. They may attend additional business counseling sessions in which business plans and other necessary management tools are discussed. Training services also are available to EAS participants upon request, but are not mandatory.

Begun as a pilot program in 1982, the EAS proved so popular that it was expanded and made available throughout Britain in 1984. The program, administered by specialist teams located in 70 job centers nationwide, is open to 50,000 potential entrepreneurs each year. By the end of 1985, 139,000 had enrolled.[16] British labor officials estimate that one-third of the participants succeed in staying off the unemployment rolls. A preliminary assessment of business survival rate is encouraging; 52 percent were still in operation three years after their launching.[17] This is comparable to the average success rate of small business in Great Britain.

The weekly allowance under EAS is funded from general revenues. The British government estimates the net cost the first year is approximately 2,690 pounds (about $4,050) for each person admitted. As these new companies begin to generate tax revenues and create additional jobs, their relative cost decreases. In fact, their net cost to the unemployment system drops to about 650 pounds (around $975) per participant at the end of 24 months.[18] More than a quarter of these new companies add at least one new employee in addition to the entrepreneur. The British government estimates that each 100 EAS businesses surviving three years creates an additional 99 jobs.[19]

The Department of Labor, together with the states, should establish a pilot program redefining the "available and looking for work" requirement to allow UI recipients to collect their benefits for a limited period of time while starting new businesses. The program could be limited to persons with a certain amount of their own money to invest in the enterprise, be targeted to those with certain education or skills levels, or could have other conditions attached that would help promote the commitment necessary for a positive outcome.

France started an Unemployed Entrepreneurs Program in 1979 as a demonstration project, and made it a national policy in 1980. Since April 1984, French citizens

entitled to unemployment compensation or welfare could collect up to 43,000 francs (about $5,500) in a lump sum to help them start a business or buy an existing one; 78 percent opt to start new companies.[20] The average French payment is $2,466. Additional grants are made for each worker the new company hires during the first six months. By the end of 1985, nearly 235,000 unemployed persons had taken advantage of the program.[21]

In a recent survey, the French government found that 51 percent of the new entrepreneurs would not have tried self-employment without the lump sum; another 26 percent indicated they probably would have foregone the attempt. More important, that same survey discovered that between 60 and 80 percent of the new firms survived for three years or more.[22] This is consistent with business success trends in France.

French officials credit entrepreneur program participants with one-third of all new business starts in France in 1984. Many of these enterprises are helping more than just the founder; they have created an average of two jobs each. About 2.7 percent now employ more than ten persons.[23]

The Department of Labor could join with states to design a pilot program offering lump sum UI payments to recipients with viable small business ideas. Like the allowance idea, certain conditions, such as structuring an acceptable business plan or attending entrepreneur counseling sessions, could be included to enhance participants' likelihood of success. **Colleges and universities can work with state and local governments and economic development agencies in establishing such threshholds and helping prospective entrepreneurs acquire the expertise to meet them.** With their management and technical assistance capacity, business course offerings, training experience, and staff expertise, they are ideally suited to lend a hand to improve the survival odds for small companies started under this type of program.

Belgium has had a program since 1984 to provide loans of up to 500,000 Belgian francs (about $11,500) to persons currently on unemployment who wish to establish a business and are willing to risk up to three years of future benefits. Interest rates on the loans are low, and the notes themselves carry generous repayment terms. The typical entrepreneur participating in this program uses the loan to leverage an additional $19,000 in commercial loans. Belgian officials indicate that about 1 percent of the unemployed on its rolls obtained help through this program during its first year.[24]

A recent study by Marc Bendick, Jr., and Mary Lou Egan examined the nature of the businesses and jobs created under transfer payment programs. In France, for example, they found that 30 percent of the businesses assisted under the entrepreneur program were service-oriented, 28 percent devoted to retail, and 22 percent in construction trades. Nearly 72 percent of these firms started with less than $7,500 in owner's equity.[25]

According to Britain's Manpower Services Commission, 66 percent of the new businesses launched under EAS auspices are service-sector firms, 15 percent construction, and 14 percent manufacturing. More than one-third of the service-sector firms are retail or business-service concerns.[26] Bendick and Egan re-

ported that more than 90 percent of the EAS-assisted firms were started with an owner's investment of less than $7,500.[27]

The experience in these two nations suggests that if the program is well targeted to the long-term unemployed, use of UI funds to help launch new business ventures could be successful in removing workers from the ranks of the unemployed. Reporting results similar to those in France, a survey of the British program found that 36 percent of the participants would not have gone into business without the government support, and another 31 percent had accelerated their start because of the assistance.[28] Thus, only one-third used their UI benefits for what they probably would have done anyway.

So far, entepreneurial assistance has been most successful for skilled workers. The majority of those participating in France's program, some 71 percent, were managers, technicians, and the like. However, the idea can also be applied to disadvantaged workers who may not be considered skilled, and it can succeed with the proper nurturing. For example, more than 100 low-income women enrolled in a business development program in St. Paul, Minnesota, have started successful businesses. These women make clothes, candies, jewelry, and toys. Their success suggests that entrepreneurship for less-skilled, disadvantaged persons can be made a feasible alternative.[29]

The European experience provides some important lessons for U.S. policy makers:

- UI can provide entrepreneurs with a significant portion of needed capital to undertake a new business venture, if they obtain it in a lump sum, as in France.
- A lump sum UI payment could serve as collateral to leverage additional money in loans, as in Belgium.
- The entrepreneurial assistance programs can be designed so they add no new costs to the existing UI program. Both the British and the French programs finance self-employment assistance from funds that the eligible person would have received anyway.
- Those businesses that do survive probably will generate important spinoff benefits in the form of additional jobs.

The UI system has provided an important service to the nation's unemployed since it began. Its explicit objective of providing income in the short-term to cover involuntary unemployment is important and must be maintained. Policy changes must not impair the capability of the UI trust fund to ensure against temporary earnings losses. However, alternatives to the basic payment function could make the system more responsive to changing labor market conditions. Maintaining persons in unemployment is not an answer to structural dislocation. When options for retraining and reemployment are available, UI recipients must be allowed to pursue them.

4. Recommendations

The UI system was designed to provide workers with a temporary financial cushion during times of economic downturn. It was conceived 50 years ago as a bridge between periods of "normalcy" in the workplace.

Since the severe economic dislocations of the mid-1970s, though, this idea of UI as a bridge has come under sharp scrutiny. Many of the jobs for which laid-off workers claimed these temporary benefits simply disappeared, as company divisions, subsidiaries, and entire firms succumbed to changes in the economic base. Many of these jobs were in traditional manufacturing industries, long an economic staple in the Northeast and Midwest. Moreover, many of the workers who found themselves displaced were not young newcomers to the work force, but middle-aged with many years of service—and facing dim prospects for retraining and reemployment.

The UI system can address the new reality of the nation's unemployment situation and become an important force in retraining and job-generating activities. Potential changes to UI range from better use of existing data for state and local program modifications to federally authorized pilot programs in entrepreneurship based on similar European experiments. These recommendations are summarized below.

State policy makers should:

- review which agency in the state is assigned the responsibility of approving training programs for UI recipients and assign this function to the most appropriate body;
- specify which training programs and/or institutions are approved automatically for providing training to UI recipients and develop clear criteria for approving other programs;
- adopt policies governing who may enroll in training while continuing to receive UI and encourage the enrollment of UI claimants who face reemployment problems;
- study historical UI data to establish whether patterns of UI exhaustion exist to help identify at earlier stages those claimants who might benefit from retraining;
- reemphasize testing and assessment activities in the Employment Service to identify UI claimants likely to need remedial education or occupational training for reemployment;
- use the ES 10 percent set-aside to strengthen the testing and assessment functions of the Employment Service;
- consider creating state training funds by substituting levies for UI taxes where UI surpluses exist; and
- take advantage of expiring FUTA penalty taxes to create state training funds where feasible.

Educational administrators should:

- determine whether training programs offered by their in-

stitutions are approved for UI recipients, and seek automatic approval where it is not granted already;
- determine what policies the state has adopted for allowing UI recipients to enroll in training, and emphasize the importance of training people while they still have some means of support available through UI;
- find out if work-sharing is authorized in their state and determine whether training would be useful option in particular work-sharing situations; and
- work with Employment Security administrators to create state training funds were feasible.

Congress should:
- direct the Department of Labor to provide technical assistance to the states on UI and training by sharing information on state approval processes and developing models to help states determine which UI recipients may benefit from retraining;
- direct the Department of Labor to expand its data collection activities to include more information on the training experiences of UI recipients, both in JTPA and other programs, and the results of these activities;
- develop positive incentives for states to combine UI and training using the offset precedent of Title III of the Job Training Partnership Act;
- explore whether other federal training programs could be considered "training with the approval of the state"; and
- authorize pilot programs to explore alternative uses of UI to promote self-employment opportunities, and earmark training and technical assistance resources for such efforts.

Notes

1. U.S. Department of Labor, Bureau of Labor Statistics, *Displaced Workers, 1979-83* (Washington, D.C., July 1985), p. 1.

2. Dan Quayle, speech delivered to Congress, *Congressional Record*, Volume 130, Number 77, June 8, 1984, p. 5.6816.

3. U.S. Department of Labor, Bureau of Labor Statistics, *Displaced Workers, 1979-83*, pp. 3-13.

4. Northeast-Midwest Institute, *The 1986 Guide to Federal Policy and the Region* (Washington, D.C., 1986), p. 2.14.

5. U.S. Department of Labor, Employment and Training Administration, *Alternative Uses of Unemployment Insurance* (Washington, D.C., 1986), p. 62.

6. Paula Duggan, *Literacy at Work: Developing Adult Basic Skills for Employment* (Washington, D.C.: Northeast-Midwest Institute, 1985), p. 4.

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11. State of California, Health and Welfare Agency, Employment Development Department, *California Shared*

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12. Paula Duggan and Virginia Mayer, *The New American Unemployment: Appropriate Government Responses to Structural Dislocation* (Washington, D.C.: Northeast-Midwest Institute, 1984), p. 29.

13. Robert Friedman, *The Self-Employment Opportunity Act of 1985* (Washington, D.C.: Corporation for Enterprise Development), p. 2.

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16. *Ibid.*

17. *Ibid.*, p. 16.

18. U.S. Department of Labor, *Alternative Uses of Unemployment Insurance*, p. 59.

19. Great Britain, Manpower Services Commission, unpublished data (Sheffield, England, 1986).

20. Marc Bendick, Jr., and Mary Lou Egan, *Transfer Payment Diversion for Small Business Development: British and French Experience*, p. 15.

21. *Ibid.*, p. 4.

22. U.S. Department of Labor, *Alternative Uses of Unemployment Insurance*, p. 60.

23. *Ibid.*

24. *Ibid.*

25. Marc Bendick, Jr., and Mary Lou Egan, *Transfer Payment Diversion for Small Business Development: British and French Experience*, p. 15.

26. Manpower Services Commission, unpublished data.

27. Marc Bendick, Jr., and Mary Lou Egan, *Transfer Payment Diversion for Small Business Development: British and French Experience*, p. 16.

28. *Ibid.*, p. 10.

29. Center for the Study of Social Policy, *Restructuring Unemployment Insurance* (Washington, D.C., 1985), p. 58.

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Acting Chairman DOWNEY. Thank you, Bill.

I have one question about the debt.

As I understand it, Illinois, Michigan, Ohio, and Pennsylvania have owed as much as $500 million; in the case of Illinois—I think that's what they have paid off.

Can you tell me about the Pennsylvania program and any reform the State has done? Has it changed the program in any way?

Mr. CLINGER. Indeed it has, Mr. Chairman.

Acting Chairman DOWNEY. Could you tell us about that?

Mr. CLINGER. In recognition of the severe indebtedness—in fact, I think at one point Pennsylvania was the most indebted State to the federal system of all the States. As a result, they have made substantial reforms some 3, 4 years ago in recognition of that and have been consistently paying back the debt that was owed to the Federal Government. And I believe—I would have to check this—but I believe that this coming year will be the final payoff, and they will be clean with the books.

But I think the thing I would try to emphasize here is the present system really makes it very difficult for States like Pennsylvania, Ohio, Illinois, and so forth, who have had traditionally the higher rates and the longer rates, to dig out from under this. They have really been—they have to pay more. They can afford to pay less—they can't afford to pay more, because they are the hardest hit.

And so one of the things that this bill does is recognize that the States that are hardest hit also have the most difficulty repaying.

Acting Chairman DOWNEY. Thank you.

Don?

Mr. PEASE. Thanks, Mr. Chairman.

And thank you, Bill, for your excellent testimony.

I am pleased to note that Ohio has paid off its debt just about a month or so ago through great cooperative effort on the part of the State government and the State's employers, who prepaid their unemployment taxes for next year in order to get Ohio's debt paid off in 1987 and avoid the rather large interest payment.

But as you point out, once you reach an unemployment level of a certain magnitude, then it's a national problem; it's not a State problem. And States like Ohio, Pennsylvania, New York, Illinois, and so on are really ill-prepared to meet the kind of excessive UI burden that they are faced with.

I'm not sure I have any questions for you. I'd just like to use your testimony as a vehicle for emphasizing a couple of points from our bill.

I presume that you would agree that one reason you and I have been striving to get unemployment insurance on the agenda early on is that when you make a change in the federal system, it takes 1½ or 2 years for implementation because the State legislatures need to amend their laws in order to conform.

And if we wait until there is a big crisis—a period of high unemployment—then the temptation is just to throw money at the problem without making the kinds of reforms that we are talking about.

Mr. CLINGER. I think that's exactly right. Because of the time lag that's involved, it really is, I think, very wise to be considering

these kinds of reforms at a time when we're not under the gun and don't have that tremendous pressure to do something which might not be a good answer.

Mr. PEASE. Sure.

Well, again, thanks very much for your testimony.

Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. Clinger, thank you for your excellent testimony.

You are suggesting to lengthen the extended benefits program from 10 to 30 weeks, so I am assuming you are folding in the old supplemental program as well.

Mr. CLINGER. We feel that the present program is sort of a hodgepodge and crazy-quilt of the programs which have kind of grown like topsy over the years and is very confusing to a lot of people.

The effort here is to try and combine it into one comprehensive program that at least makes some sense and eliminates some of the confusion that presently exists.

But yes, it would provide for folding that in. It would not increase necessarily from 13 to 30. It goes from 10—it reduces in some cases—to 10 weeks but could go as high as 30.

Mr. FRENZEL. That would be for all States?

Mr. CLINGER. All States.

Mr. FRENZEL. Without respect to how long a claimant worked to earn the benefits?

Mr. CLINGER. It would—that would be taken into account. In other words, what we're looking at here are the States that have the longest, most—sort of—systemic problems would be entitled to the longer period of time, based——

Mr. FRENZEL. But what I'm getting at is this: when the FSB was in effect, it was possible, in a State like Maryland, for example, to work a couple of weeks and get 52 weeks of unemployment through EB and FSB.

Under your plan, what happens to people who work for a period of time less than that required to earn the full duration of benefits in their own States and then run out of benefits?

Mr. CLINGER. I'm not sure I have the answer to that.

Mr. Pease?

Mr. PEASE. If the gentleman would yield.

I think that's a good point, Bill. I think the assumption in our bill is that if a State triggers on to extended benefits by having a certain unemployment level, you would take it as a given that after the first 26 weeks of unemployment paid for by the State, any worker who was eligible would be eligible for the additional 10 or 15 weeks or whatever, according to the level of unemployment.

One of the purposes of this hearing—certainly the reason I am interested in the hearing—is to have questions raised that we need to address, and I think that is a good one.

I would like to have our staff look over what the eligibility requirements are from State to State to see if they're reasonably uniform. And probably it would be in order to at least have a required minimum threshold at the State level before workers could benefit from these additional——

Mr. FRENZEL. You may have some workers who do not qualify for the full duration of benefits within their State, but to whom you nevertheless want to offer extended benefits. There will certainly be some whom you don't want to give extended benefits or to whom you want to give less than the full ration.

Mr. Clinger, does your bill contemplate variable rates? Or does it just contemplate a variable duration?

Mr. CLINGER. That's correct, just variable duration.

Mr. FRENZEL. As you know, there are some observers of the unemployment scene who say the more you subsidize unemployment, the more unemployment you get. And if you place a high value on unemployment, you can buy quite a lot of it.

You are also talking about jobs that are disappearing—a restructuring in our society where people are going to wait in vain to be recalled to the old job.

Is there anything in your plan other than the financial incentives in the State, to give claimants some incentive to get off the system?

Mr. CLINGER. Yes, we think there is.

As you know, in some States—although fewer all the time—there is now an incentive, really, to stay on the system because you are discouraged from going into any kind of retraining or learning any new skills. Because the minute you do, you are cut off from unemployment compensation.

This bill would recognize that that is a disincentive and would say that you could not be taken off benefits by virtue of the fact that you were going into some sort of retraining under title III of JTPA or whatever.

And the objective here is we think that it would encourage people indeed to seek new skills if you can once convince them that that job is not going to come back.

Now, that's not easy, because I know—in my own case I deal with a lot of unemployed steelworkers, frankly, who just are not prepared yet to admit that the steel industry is never going to recover to the extent that it was. So it's hard to convince them sometimes that they really should—they would be doing themselves a favor if they took retraining and took it early.

But that's the objective—to try and encourage people to go into retraining at an earlier stage and hopefully then get them off the system.

Mr. FRENZEL. You didn't think about a declining scale of benefits?

Mr. CLINGER. That is not included.

I think that's something that might well be considered. That is not included in this particular provision, though.

Mr. FRENZEL. I notice you provide for demonstration of sub-State triggers.

The first hearing this subcommittee conducted after it was created in the 1970s was to investigate the feasibility of sub-State triggers. No administration has ever wanted to administer that kind of program.

You are providing only for a demonstration, not for——

Mr. CLINGER. Full-scale—that's right.

Mr. FRENZEL. Have you determined where the demonstration will be conducted, or do you leave that to the administration?

Mr. CLINGER. Well, we give them some guidelines as to the sorts of States that should be selected for this.

And it really is depending on the incidence of long-term unemployment, how serious it is, what the—there are indicia that we ask them to look at in determining which States should be selected on a trial basis.

Mr. FRENZEL. Can you explain to me just in general terms how your total unemployment rate compares with the insured unemployment rate in the current program?

Mr. CLINGER. Well, under present law, as you are aware, IUR is what you look at in determining whether or not the trigger goes into effect.

Mr. FRENZEL. Sure. But the TUR and the IUR do not have an exact correlation.

Mr. CLINGER. They do not have a correlation. That is correct.

Mr. FRENZEL. But they do have some correlation.

Mr. CLINGER. Some. But for example——

Mr. FRENZEL. Have you in fact then raised the threshold or lowered it by going to whatever your standards are?

Mr. CLINGER. I think in cases where you have had long-term unemployment—large numbers of people long-term unemployed—it would raise it. In other words, you would have more people—you would trigger quicker, because there would be more people who would be considered as unemployed.

Because you have—in Pennsylvania again, you have a lot of people who have exhausted all benefits, have been unemployed for longer periods of time, but do not show up on any rolls—who are off the—they're obviously not under the insured program. Therefore, they would not show up.

So it would include larger numbers of people.

Mr. FRENZEL. Sure.

I assume, Mr. Chairman, that we will get a staff analysis of this bill or any other vehicle we're working on and that the analysis will enable us to compare the number of workers who would be covered. I assume we will also get a CBO analysis of costs.

Mr. CLINGER. I would just say that I think it's very difficult at this point to cost out these things, as you are aware.

But there are—the two things that I think would help to hold the costs of this down are—one, the encouragement to get off the unemployment and into a training program and hopefully get into a job——

Mr. FRENZEL. Now, on your first asterisked item—the demonstration of financial incentive—is that a carrot and a stick or merely a carrot?

Mr. CLINGER. Is this—I'm sorry.

Mr. FRENZEL. Is the financial incentive to the State simply a carrot, is it both a carrot and a stick; or what is it?

Mr. CLINGER. It is—I'm not sure I can say that there is a stick in there.

Mr. FRENZEL. It is simply a larger contribution based on the number of people they enroll?

Mr. CLINGER. In training—that's right.

Mr. FRENZEL. I'd like to compliment you on the next one.

There is a typo in your statement, and I hope someone corrects that.

Mr. CLINGER. Yes, there is. I just saw that. Thank you, Mr. Frenzel.

It's a little more complicated than just "stating" their own businesses.

Mr. FRENZEL. Exactly. It's a splendid idea.

Mr. Chairman, I have lots of questions on this issue, but we have lots of witnesses. I yield to the gentleman from Ohio.

Mr. PEASE. If the gentleman would yield.

If I might make just one comment on the TUR, just for the sake of your own enlightenment.

As you point out, the TUR is somewhat less precise than the IUR. As Mr. Clinger has pointed out, in States with chronic unemployment or long-term unemployment, the IUR tends to go down after a year or so as people exhaust all their benefits and as States trigger off of—currently—the extended benefits program.

We provide TUR's as an alternative. In recognition of the fact that it is less precise, thresholds are fairly high for TUR.

For example, you would have to hit 9 percent TUR before workers would be eligible for any additional weeks beyond the first 26. And at that, they would be eligible for only 10 weeks.

Some will criticize. We have some witnesses from the AFL–CIO coming in today to say that those thresholds are too high.

But our intention is to have a reasonable midpoint so that those States that trigger off of IUR aren't without benefits entirely while having very high unemployment rates.

Mr. FRENZEL. Thank you very much. I yield my time.

Acting Chairman DOWNEY. Thank you, Bill.

Congressman Coyne is on his way. But while he is on his way here, the subcommittee will now hear from the Department of Labor, the Honorable Roberts T. Jones, Deputy Assistant Secretary for Employment and Training; and from the U.S. General Accounting Office, William J. Gainer, Associate Director, Human Resources Division.

Mr. Jones, if we could hear from you first, sir. And your statements, charts, or studies will be made subject to the record with the members' consent.

STATEMENT OF HON. ROBERTS T. JONES, DEPUTY ASSISTANT SECRETARY FOR EMPLOYMENT AND TRAINING, U.S. DEPARTMENT OF LABOR, ACCOMPANIED BY CAROLYN GOLDING, DEPUTY ADMINISTRATOR OF THE OFFICE OF EMPLOYMENT SECURITY; AND PATRICIA McNEIL, ADMINISTRATOR OF THE OFFICE OF STRATEGIC PLANNING AND POLICY DEVELOPMENT

Mr. JONES. Thank you, Mr. Chairman.

I am accompanied today by Ms. Carolyn Golding, who is the Deputy Administrator of the Office of Employment Security, and Ms. Patricia McNeil, who is the Administrator of our Office of Strategic Planning and Policy Development.

I am pleased to testify before you today and provide the administration's views on the five issues and questions that you have put forward.

We would also like to comment specifically on H.R. 2676, the Extended Unemployment Insurance Act, introduced by Mr. Pease, and 3213, the Unemployment Insurance Reemployment Demonstration Projects Act introduced by Mr. Levin.

The first issue the subcommittee raises: Do States have sufficient reserves in their unemployment funds?

I am pleased to report that, on the whole, State reserves are fairly healthy. In part, this is attributable to an unprecedented 5-year expansion of the economy. Trust fund balances for those States with positive balances at the end of June 1987 totaled $23.3 billion.

The Department does not have a solvency standard by which the adequacy of State reserves can be measured. However, we do know that as of June 30, 1987, 27 States had a balance sufficient to pay benefits at their current rate of expenditure for 18 months. An additional 11 States had balances ranging from 17.4 to 14.1 times their current monthly benefit rates.

At the other end of the spectrum, three States continued to have outstanding loans from the Federal Government. And another seven States, while not in debt, have funds that equal less than eight times their current monthly benefit rates.

From a peak of 31 States with loans from the Federal Unemployment Account in April of 1983 and a peak indebtedness of $14 billion in March of 1984, indebtedness has decreased to the point where, at present, 3 states have a total outstanding indebtedness of about $2 billion.

Present indications are that by 1990 all States will have paid off current loans and will be building reserves.

The second question posed by the committee is: Do existing programs provide adequate coverage of the work force?

Mr. Chairman, the Federal Unemployment Tax Act and related unemployment insurance laws, such as those covering railroad workers and Federal employees and ex-service members cover 97 percent of all jobs in this Nation in which persons work for salaries or wages. This coverage is about as broad as that in any country.

The role of the UI system, since its enactment in 1935 has been to furnish temporary partial wage replacement for a limited period of time, to individuals with recent substantial attachment to the labor force who are out of work due to no fault of their own. Conditions of benefit eligibility are established under individual State law and are not, in general, subject to Federal requirements.

Over recent years a lower proportion of the unemployed have received UI benefits. This has been a subject of concern in the UI system and to the Department. In 1986 an average of 33 percent of the unemployed were claiming benefits at any one time—an all-time low. This low rate is continuing in 1987 with a low of 25 percent recorded in October of 1987. The all-time high was 75 percent in 1975, a recession year in which permanent and temporary UI programs provided up to 65 weeks of benefits. A more relevant comparison is with the nonrecession year of 1979 in which an average of 42 percent of the unemployed claimed benefits. The decline

from this level to the current level is the one on which we have focused our attention. For example, current population survey and other data indicate that of those unemployed in October of 1987, a significant number are new entrants to the labor force and reentrants without work experience who are simply not eligible for unemployment insurance. These new entrants and reentrants averaged nearly 40 percent of the total unemployed in that month.

Also in October, an additional 8 percent had been unemployed for more than 6 months—beyond the time most States pay UI benefits. In addition, most State laws disqualify workers who leave their jobs voluntarily without good cause. This excludes an additional 15 percent of the unemployed.

That leaves the remainder of 37 percent on which we have focused our analysis and research. About 25 or 26 percent were UI claimants. About 6 percent filed claims but were ineligible, leaving 9 to 10 percent who appear to have been eligible but who did not claim benefits.

In addition to analysis within the Department, we have funded two independent studies to try to shed light on this problem. The first was completed by the Brookings Institution in 1984 based on national aggregate data. That study listed some potential causes for the decline but did not quantify their separate effects. The second is a study currently being done by Mathematica Policy Research and is attempting to go beyond the first study by using State-specific data and by studying State law and administrative changes in detail. The results of this study are due early in 1988. I will be happy to share the results when they are available and to work with the committee to determine any appropriate action which should be taken.

The third question: Would the current Federal-State extended benefit program provide the additional protection needed during a period of high unemployment?

The current EB program is designed to provide benefits when unemployment in a State is high—an insured unemployment rate of 5 percent or more. State rates as of October 10, 1987, ranged from a high of 4.71 in Alaska to a low of 0.42 in New Hampshire. As a result, no State is currently paying extended benefits. On the other hand, during the last recession these same triggers activated EB in 30 States between October 1, 1982 and July 1, 1983.

The issue of what level of EB protection is needed is a difficult one, requiring balancing between the economic benefit to unemployed workers and their families and communities, and the costs to the economy and employers, including reduction in business' ability to create and maintain payroll jobs. In the past, Congress has responded to this issue in a variety of ways. Any appropriate response in the future would have to be based on an evaluation of the conditions prevailing at that time.

The fourth issue: Has the stabilizing effect of the unemployment compensation/public assistance programs during periods of high unemployment been impaired because of reductions that have been enacted in recent years?

I can respond only with respect to unemployment compensation.

There are three different ways to assess unemployment compensation's stabilizing effect: first, by the proportion of unemployed

who claim unemployment compensation; second, the rate at which claimants exhaust their benefits; and third, the ratio of benefits to weekly wages or the degree of wage replacement.

Let me describe these.

First, the proportion who claim UI. We have already discussed this issue earlier—I would add that although we don't have all the answers, there are some things we do know about the decline. There is a decline in the proportion of newly unemployed workers who file an initial claim. In response to the solvency problems of the late 1970's and early 1980's, many States changed their programs in other ways which had the effect of reducing the number of claimants, mainly by tightening eligibility and disqualification criteria. Also, some Federal actions clearly reduced the incentives to collect UI benefits, including pension offsets and the taxation of UI benefits.

We don't know the relative weights or impacts of these actions, but we do know that they have contributed. The study we referred to earlier will give us some insights into this.

Second, exhaustions: One measure usually considered in evaluating the economic or stabilizing effects of the UI program is the percentage of claimants who exhaust all rights to benefits. An increase in the exhaustion rate over the prior periods can be viewed as an indicator that the stabilizing effect of the program has been weakened. This turns out not to be the case. For the 10-year period from 1977 through 1986, the average annual exhaustion rate was 32.7 percent. Rates were highest in 1982 and 1983—38.5 and 38.4 respectively. The rate for 1986 was 32.5 percent—virtually identical with 32.7 in the 10-year period.

Exhaustion rates vary widely among States, reflecting differences in the provisions of State UI laws and economic circumstances. For the third quarter of fiscal 1987 ending on June 30, the rates in individual States varied from a low of 3.15 percent in New Hampshire to a high of 60.7 in Louisiana.

Third, the degree of wage replacement. Another measure usually considered in evaluating the stabilizing effect of the UI program is benefit adequacy. Again, as with the rate of benefit exhaustions, the ratio of average weekly benefit amount to average weekly wage has remained virtually constant during the 10-year period between 1975 and 1985. The ratios range from a high of 37.5 percent in 1982 to a low of 35.2 in 1983. The highest ratio in the history of the program came in 1938—43.1 percent. In 1985 it was 35.3.

Finally, the last question: Are there alternative uses of UI funds that could make more efficient use of UI dollars?

We are conducting a variety of demonstration projects to help us and the Congress answer this question. This issue also brings us to the consideration of the relevant portions of the two bills the subcommittee asked us to address. H.R. 3213 would authorize a series of demonstration projects. We applaud the purpose of this bill. However, we don't feel that passage is appropriate at this time because we already have a number of demonstrations under way which should yield useful information and which we ought to assess before acting on such proposals. We have four projects under way which share the objectives of 3213.

In September 1985, the New Jersey reemployment demonstration project was launched. Since then we have initiated three new reemployment demonstrations designed to expand on the results of that project. This series of initiatives is designed to test our ability to identify structurally unemployed UI recipients early in their spell of unemployment, provide early intervention services designed to speed return to work, improve linkages between UI and other service delivery agencies such as the Job Service, JTPA, and economic development agencies, and to create effective reemployment services.

The New Jersey project is examining the effectiveness of three alternative packages of services that utilize job search assistance, training, relocation, assistance, and cash bonuses for early reemployment. An interim report on this project was issued in April 1987, and we anticipate a final report next year. So far, the results appear quite promising.

The States of Pennsylvania and Washington have been selected to operate demonstration projects designed to explore the effectiveness of a cash incentive for early reemployment. The reemployment bonus will be offered to new claimants who are expected to have difficulty in returning to work.

The State of Washington has also been selected to conduct a self-employment demonstration project. The concept of self-employment as an alternative use of UI trust funds is as yet untried in this country.

These latter three projects are just beginning, and we do not anticipate having results for evaluation for some time. Because we have already undertaken these projects under current research authority, we believe the results of these projects should be evaluated before considering additional proposals such as those in H.R. 3213.

H.R. 2676 would amend the EB program and authorize a series of demonstration projects. We oppose the demonstrations part of the bill for the same reasons we oppose 3213. We oppose the EB portion of this legislation on the grounds of cost, administrative complexity, and because we are opposed to establishing in legislation a new program before we see the scope and scale of the unemployment problem it's designed to address.

With respect to the costs, we have prepared estimates under two assumptions: first, under the current midsession economic assumptions issued jointly by OMB, the Council of Economic Advisers and the Treasury Department; and second, under a recessionary scenario. In each case, H.R. 2676 would be considerably more costly for fiscal 1989 for both the Federal Government and the State governments.

First, under current midsession assumptions with an IUR of 2.2 percent, current law costs of the EB program would be $8 million, divided equally between Federal and State Governments. Under 2676, using the same 2.2 percent and a total unemployed rate of 5.8 percent, costs would jump to $378 million, an increase of $370 million, of which $257 million would be payable by the Federal Government and $121 million by the States.

Second, under a recessionary scenario with an insured unemployment rate of 4.3 percent, current law costs for the EB program would be $2.1 billion, divided equally between Federal and State

governments. Under H.R. 2676, using the same IUR of 4.3 percent and a total rate of 8.6 percent, costs would be $4.2 billion—almost double the amount under current law, divided at $2.9 billion payable by the Federal Government and $1.2 billion by the States.

Finally, Mr. Chairman, we think that State flexibility and authority is very important in the unemployment insurance program and should be examined further. The administration proposed legislation this year to require transfer of authority and responsibility for administering unemployment insurance to the States. We urge the Congress to give this proposal active consideration.

This completes our statement. We appreciate the opportunity to be here and to participate in any questions that you may have.

[The statement of Secretary Jones follows:]

STATEMENT OF
ROBERTS T. JONES
DEPUTY ASSISTANT SECRETARY OF LABOR
FOR EMPLOYMENT AND TRAINING
BEFORE THE
SUBCOMMITTEE ON PUBLIC ASSISTANCE
AND UNEMPLOYMENT COMPENSATION
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

DECEMBER 14, 1987

Mr. Chairman and Members of the Subcommittee, I am pleased to testify before you today and to provide the Administration's views on the five issues the Subcommittee has raised in its invitation. I will also comment specifically on H.R. 2676, the Extended Unemployment Insurance Act of 1987, introduced by Mr. Pease, and H.R. 3213, the Unemployment Insurance Reemployment Demonstration Projects Act introduced by Mr. Levin.

The first issue the Subcommittee raises is: Do States have sufficient reserves in their unemployment funds?

I am pleased to report that, on the whole, State reserves are healthy. In part, this is attributable to an unprecedented 5-year expansion of the economy. Trust fund balances for those States with positive balances at the end of June 1987 totaled $23.3 billion.

The Department does not have a solvency standard by which the adequacy of State reserves can be measured. However, we do know that, as of June 30, 1987, 27 States had a balance sufficient to pay benefits at their current rate of expenditure for 18 months. An additional 11 States had balances ranging from 17.4 to 14.1 times their current monthly benefit rates.

At the other end of the spectrum, 3 States continue to have outstanding loans from the Federal Government and another 7 States, while not in debt, have funds that equal less than 8 times their current monthly benefit rates.

From a peak of 31 States with loans from the Federal Unemployment Account in April 1983, and a peak indebtedness of $14 billion in March 1984, indebtedness has decreased to the point where, at present, 3 States have a total outstanding indebtedness of about $2 billion.

Present indications are that by 1990 all States will have paid off current loans and will be building reserves.

The second question posed by the Subcommittee is: Do existing programs provide adequate coverage of the workforce?

Mr. Chairman, the Federal Unemployment Tax Act and related unemployment insurance laws, such as those covering railroad workers, Federal employees, and ex-servicemembers, cover 97 percent of all jobs in this Nation in which persons work for salaries or wages. This coverage is about as broad as that in any country.

The role of the UI system, since its enactment in 1935, has been to furnish temporary partial wage replacement, for a limited period of time, to individuals with recent and substantial attachment to the labor force who are out of work due to no fault of their own. Conditions of benefit eligibility are established under individual State law and are not, in general, subject to Federal requirements.

Over recent years a lower proportion of the unemployed have received UI benefits. This has been a subject of concern in the UI system and to us. In 1986, an average of 33% of the unemployed were claiming benefits at any one time, an all-time low. This low rate is continuing in 1987, with a low of 25% recorded in October of 1987. The all-time high was 75% in 1975, a recession year in which permanent and temporary UI programs provided up to 65 weeks of benefits. A more relevant comparison is with the non-recession year of 1979, in which an average of 42% of the unemployed claimed benefits. The decline from this level to the current level is the one on which we have focused our attention. For example, Current Population Survey and other data indicate that of those unemployed in October 1987, a significant number are new entrants to the labor force and reentrants without work experience who are simply not eligible for UI. These new entrants and reentrants averaged nearly 40% of the total unemployed in that month. Also in October, an additional 8% had been unemployed for more than 6 months -- beyond the time most States pay UI benefits. In addition, most State laws disqualify workers who leave their jobs voluntarily without good cause. This excludes an additional 15% of the unemployed. That leaves the remainder of 37% on which we have focused our analysis and research. About 25-26% were UI claimants; about 6% filed claims but were ineligible, leaving 9-10% who appear to have been eligible, but who did not claim benefits.

In addition to analysis within the Department, we have funded two independent studies to try to shed light on this problem. The first was completed by the Brookings Institution in 1984 based on national aggregate data. That study listed some potential causes for the decline but did not quantify their separate effects. The second is a study currently being done by Mathematica Policy Research and is attempting to go beyond the first study by using State-specific data and by studying State law and administrative changes in detail. The results of this study are due early in 1988, and we will be happy to share the results when they are available and work with you to determine any appropriate action to be taken.

The third question presented by the Subcommittee is: Would the current Federal-State extended benefit program provide the additional protection needed during a period of high unemployment?

The current EB program is designed to provide benefits when unemployment in a State is high--an insured unemployment rate of 5 percent or more. State rates as of October 10, 1987, ranged from a high of 4.71 in Alaska to a low of 0.42 in New Hampshire. As a result, no state is currently paying extended benefits. On the other hand, during the last recession, these same triggers activated EB in 30 States between October 1, 1982 and July 1, 1983.

The issue of what level of EB protection is "needed" is a difficult one requiring balancing between the economic benefit to unemployed workers and their families and communities, and the costs to the economy and employers, including any reduction in business' ability to create and maintain payroll jobs. In the past, Congress has responded to this issue in varying ways. Any appropriate response in the future would have to be based on an evaluation of the conditions prevailing at that time.

The fourth issue raised by the Subcommittee is: Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions that have been enacted in recent years in these programs?

I can respond only with respect to unemployment compensation.

There are three different ways to assess unemployment compensation's stabilizing effect and its changes over time:

First, by the proportion of unemployed who claim unemployment compensation.

Second, by the rate at which claimants exhaust their unemployment compensation benefits.

Third, by the ratio of benefits to weekly wages--or degree of wage replacement.

I will describe each of these in turn.

(1) Proportion who claim UI

I have already discussed this issue earlier. I would add that, although we don't have all the answers, there are some things we do know about the decline. There is a decline in the proportion of newly unemployed workers who file an initial claim for UI benefits. In response to the solvency problems of the late 70's and early 80's, many States changed their programs in other ways which had the effect of reducing the number of claimants, mainly by tightening eligibility and disqualification criteria. Also, some Federal actions clearly reduced the incentive to collect UI benefits, including pension offset and the taxation of UI benefits. We don't know the relative weights or relative impacts of these actions but we do know that they contributed. The study we referred to earlier should show relative impact and may identify additional contributory factors.

(2) Exhaustions

One measure usually considered in evaluating the economic or stabilizing effect of the UI program is the percentage of claimants who exhaust all rights to benefits. An increase in the exhaustion rate over that of prior periods can be viewed as an indicator that the stabilizing effect of the program has been weakened. This turns out not to be the case. For the 10-year period from 1977 through 1986, the average annual exhaustion rate was 32.7%. Rates were highest in 1982 and 1983 (38.5 and 38.4, respectively). The rate for 1986 was 32.5 percent, virtually identical with the 32.7% 10-year average.

Exhaustion rates vary widely among States reflecting differences in the provisions of State UI laws and in economic circumstances. For the third quarter of FY 1987, ending on June 30, the rates in individual States varied from a low of 3.15% in New Hampshire to a high of 60.7% in Louisiana.

(3) Degree of wage replacement.

Another measure usually considered in evaluating the stabilizing effect of the UI program is benefit adequacy. Again, as with the rate of benefit exhaustions, the ratio of average weekly benefit amount to average weekly wage has remained virtually constant during the 10-year period between 1975 and 1985 (the last year for which data are available). The ratio has ranged from a high of 37.5% in 1982 to a low of 35.2% in 1983. The highest ratio in the history of the program came in 1938--43.1%. In 1985, it was 35.3%.

Finally, the fifth question posed by the Subcommittee is: Are there alternative uses of UI funds that could make more efficient use of UI dollars?

We are conducting a variety of demonstration projects to help us and the Congress answer this question. This issue also brings us to the consideration of the relevant portions of the two bills the Subcommittee asked us to address. H.R. 3213 would authorize a series of demonstration projects. We applaud the purpose of this bill. However, we don't feel that passage is appropriate at this time because we already have a number of demonstrations underway which should yield useful information and which we ought to assess before acting on such a proposal. We have four projects underway which share the objectives of H.R. 3213.

In September 1985, the New Jersey Reemployment Demonstration Project was launched. Since then, we have initiated three new reemployment demonstrations designed to expand on the results of the New Jersey project. This series of initiatives is designed to: test our ability to identify structurally unemployed UI recipients early in their spell of unemployment; provide early intervention services designed to speed return to work; and improve linkages between UI and other service delivery agencies such as the Job Service, JTPA and economic development agencies, to create effective reemployment services.

The New Jersey project is examining the effectiveness of three alternative packages of services that utilize job search assistance, training, relocation assistance and a cash bonus for early reemployment. An interim report on this project was issued in April 1987 and we anticipate a final report next year. So far, the results appear promising.

The States of Pennsylvania and Washington have been selected to operate demonstration projects designed to explore the effectiveness of a cash incentive for early reemployment. The reemployment bonus will be offered to new claimants who are expected to have difficulty in returning to work.

The State of Washington has also been selected to conduct a self-employment demonstration project. The concept of self-employment as an alternative use of UI trust funds is, as yet, untried in the U.S.

These latter three projects are just beginning and we do not anticipate having results for evaluation for some time. Because we have already undertaken these projects under current research authority, we believe the results of these projects should be evaluated before considering additional proposals such as those in H.R. 3213.

H.R. 2676 would amend the EB program and authorize a series of demonstration projects. We oppose the demonstrations part of the Bill for the same reasons we oppose H.R. 3213. We oppose the EB portion of this legislation on the grounds of cost, administrative complexity, and because we are opposed to establishing in legislation a new program before we see the scope and scale of the unemployment problem its designed to address.

With respect to the costs, we have prepared estimates under two assumptions: first, under the current midsession economic assumptions issued jointly by OMB, the Council of Economic Advisors, and the Treasury Department; and second, under a recessionary scenario. In each case, H.R. 2676 would be considerably more costly for FY 1989 for both the Federal Government and the States.

First, under current midsession assumptions, with an IUR of 2.2 percent, current law costs of the EB program would be $8 million, divided equally between Federal and State governments. Under H.R. 2676, using the same IUR of 2.2 percent and a total unemployment rate (TUR) of 5.8 percent, costs would jump to $378 million, an increase of $370 million, of which $257 million would be payable by the Federal Government and $121 million by the States.

Second, under a recessionary scenario, with an IUR of 4.3 percent, current law costs of the EB program would be $2.169 billion, divided equally between Federal and State governments. Under H.R. 2676, using the same IUR of 4.3 percent and a TUR of 8.6 percent, costs would be $4.223 billion, almost double the amount under current law, divided at $2.959 billion payable by the Federal Government and $1.264 billion by the States.

Finally, Mr. Chairman, we think that State flexibility and authority is very important in the unemployment insurance program and should be examined further. The Administration proposed legislation this year to require transfer of authority and responsibility for administering unemployment insurance to the States. We urge Congress to give this proposal active consideration.

Mr. Chairman, this completes my formal statement. I will be happy to answer any questions you may have.

Acting Chairman DOWNEY. Thank you, Mr. Jones.
Mr. Gainer?

STATEMENT OF WILLIAM J. GAINER, ASSOCIATE DIRECTOR, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY SIGURD R. NILSEN, SENIOR ECONOMIST; AND CHARLES A. JESZECK, PRINCIPAL ANALYST

Mr. GAINER. Thank you, Mr. Chairman.

I have with me today our senior economist, Sigurd Nilsen, who heads up most of our work on unemployment insurance and employment service and dislocated workers at GAO, and Charlie Jeszeck, who is the principal analyst on the work we have done on the solvency of the UI trust fund.

We are going to confine our remarks today to addressing your first question, which gets to the adequacy of the current trust fund reserves for the various States.

We have been doing a fairly large study of the data available to us from the Department of Labor and the various States on the trust fund balances, the current recipiency rates in the States, and some information on what the States have done to adjust to solvency problems which remain from the last recession.

In particular, we have analyzed trust fund reserve balances, the recipiency rates, the causes of the trends in solvency and reserve adequacy. And we have looked at the projected impact of a recession in the future on the adequacy of the reserves that are now held in these funds.

Overall, we find that many of the UI trust funds are not currently maintaining reserves sufficient to pay benefits during the next recession. Even if the current economic expansion were to continue into the 1990's, trust fund reserves would be expected to remain inadequate.

A variety of Federal policies such as charging interest on Federal loans to States have increased short-term solvency in the States because the costs of insolvency have increased. However, these policies have not encouraged States to hold adequate long-term reserves but merely to avoid short-term borrowing. The States have, however, reduced the benefits that they provide to their work force.

We believe that unless these current funding practices and perhaps the Federal incentives that are there are changed, you will see a significant number of insolvent State funds in the next recession, and the States will respond in the same way they have in the past few years—by taking a variety of measures to both increase revenue but at the same time reduce the benefits that they provide to workers.

I'd like to go through each of these points in a little greater detail, and we have some charts over here that I'll refer to from time to time.

To determine whether State trust fund reserves are being maintained at levels sufficient to pay benefits during times of increased unemployment, we looked at trends in the most commonly used measure of financial adequacy, known as the high-cost multiple. I should note that we looked at about 10 or 15 other measures as

well, which I'm sure you wouldn't want to hear about today, because they would bore you to tears. But I think this one measure—the so-called high-cost multiple—will give you a good idea of what the adequacy position of these State funds are.

In the past, the Department of Labor recommended that States voluntarily keep a high-cost multiple of about 1.5. Let me tell you what that means, roughly speaking. The arithmetic is somewhat complicated, but this standard is equivalent to requiring that reserves be sufficient to pay recession-level benefits for 1½ years.

In 1986, the high-cost multiple for the entire system was 0.44, and that would be equivalent to the ability to pay benefits in a recession—and in this case, it would be the worst recession that any of these States had encountered. Very often, that would be the 1975 recession and in some cases, the 1982 recession. That would be equivalent to benefits for 5 months in that kind of recession.

Now, 5 months is much shorter than the average of all modern recessions, which has been about 12 months.

As for the individual trust funds, 39 States had adequate trust funds using this 1.5 high-cost multiple, or an 18-month standard, in 1969. But only two States had adequate reserves in 1975.

Now, it's been argued that the standard of 1.5—since it would provide recession-level benefits for a year and a half—is unrealistically high because most of our recessions have averaged 12 months. So using a 12-month standard, you go back and look at the adequacy of these State funds and you find that in 1986, only 11 States had trust funds adequate to pay recession-level benefits for 12 months.

About eight States were insolvent in 1986, according to year-end figures. And I know that those have changed somewhat since. But only very few of the States were maintaining balances which would have been adequate. In fact, 34 did not maintain balances adequate to get through one year of recessionary benefits.

In the last recession, 23 States became insolvent for all of 1983 and were forced to borrow from the Federal Government. The new loans in that year went to $7.8 billion.

We also did a number of calculations and had Labor do some simulations of future recessionary situations which I'd like to share with you.

The UI trust fund has increased substantially as a result of the expansion that we are going through and which has been the longest peace-time expansion in modern times. And the trust funds now hold $23 billion in the aggregate in 1987. However, despite this increase in reserve growth, we believe the financial health of this system is still not strong.

As I said, the Department of Labor ran some simulations for us. And based on the administration's assumptions for continued economic growth well into the 1990's, aggregate reserves in the fund would continue to grow and would reach $25 billion in 1990.

Yet the high-cost multiple which I referred to earlier would barely move from its present level of 0.44. The reason for that is that although revenue growth to these funds would continue and the funds that were solvent would continue to earn money on interest from the Federal Government, this growth would just be marginally greater than the growth in both the work force and the

wages paid to the work force, so that if you look at the likely ability of States to pay benefits in a recession, it really isn't going to improve.

We also used a Labor model to analyze the possible impact of a moderate recession in 1988 which would be, let's say, equivalent to the average of the last five recessions. We fed in assumptions on unemployment rates and length and so on, averaging out the last five recessions.

This simulation shows that the financial condition of the UI system could be expected to deteriorate rapidly. The number of insolvent States would increase to 17, with Federal loans increasing to $7 billion.

Even assuming a recovery, then, in 1989—that is, a rather brief recession in 1988—17 trust funds would be insolvent in that year, and total Federal borrowing would remain at $5.7 billion.

To further illustrate, I'll give you an example based on a simulation done by a consultant for us on the Massachusetts system, which is sort of in average condition. It has a substantial fund—about $1 billion in reserves. It has a high-cost multiple of about 0.61, which would mean that it could withstand the worst recessionary benefit payouts in the history of that State for perhaps 6 or 7 months.

Projections predict that the fund would avoid insolvency during a moderate recession beginning in 1990, although reserves would be reduced from their current $1 billion to about $90 million.

However, in a more severe recession—but not as severe as the 1980 recession—and under the Massachusetts current benefit and revenue picture, we would expect that fund, even though it's a pretty healthy one, to require an estimated $800 million in Federal loans to pay its benefits during a recession of that kind.

Now, the next chart I have looks at the causes of this solvency situation that we have right now.

First of all, the—let's say—historic high unemployment rates that we've had in the 1980's as compared to earlier decades mean that these funds are paying over a long period of time benefits to a larger number of people. In the 1982-83 recession, the number of higher-wage workers who were unemployed—which is typical of a recession—went up, meaning that the benefits that they qualified for increased. And you've had more workers in this decade than in earlier decades who get the full 26 or 30 weeks or whatever is available in that State—get the full range of benefits so that helps exhaust the funds.

At the same time, if you look at it on the benefits side, a lot of States have indexed their benefits to wage inflation. However, most of these States have not indexed their revenues, so the revenue picture is, in many cases, about as it was prior to the significant wage inflations that we saw in the late 1970's and early 1980's and just not keeping up with the benefits.

As regards the question of extended benefits, the State trust funds have not been structured in the past to cover their share of the extended benefits. That has caused a degradation in the solvency of these funds.

And I should say that if you look at this high-cost multiple—if you look at the chart I have up there on the right, you see that

over a long period of time since 1969, the solvency figures have continued to go down—I mean, the adequacy figures have continued to go down in and out of recessions. And regardless of what has happened in the economy, that adequacy measure is on a continuing downward trend until 1983, where the whole fund essentially was inadequate. And it has crept back up now a bit.

I mentioned earlier that some of the Federal policies which have been designed to help with this solvency problem or to help with the adequacy of reserves really, as far as I can tell, are not working to improve reserves.

There have been a series of things that have occurred—penalty taxes, an increase in the interest rates charged on loans to States from the Federal unemployment fund—which have had the tendency to make States want to pay back their loans, just as Ohio did, before they trigger that increase in interest rates.

But it really has not encouraged States to build a reserve for the future or to build a reserve which will enable them to withstand a future recession. And I think that's an important thing to understand.

Those incentive systems really have not worked the way people had hoped, I don't believe.

However, they have had the impact of reducing benefits. And I'd just like to mention a couple of examples of that.

Thirty-five States have increased the earning level required for minimum weekly benefits, while 18 States changed their eligibility requirements to reduce the number of unemployed receiving benefits.

Now, that's true that about 97 percent of wage earners and salaried people are covered by the system. However, that doesn't mean that 97 percent of the people are likely to receive benefits, because there has been a substantial tightening at the State level.

Now, that's not the only reason that benefits are going down. There a wide range of economic factors, some of which Mr. Jones mentioned, which have tended to lower the recipiency rate for UI.

But I think these insolvency measures of the Congress and the States' response to those measures have had an effect on that recipiency rate.

So if I could just sum up our argument a little bit—despite the recent accumulation of what may appear on the surface to be significant reserves, the UI system still remains fragile. The number of trust funds with adequate reserves has declined and is likely to increase only moderately, even if the economy continues to expand for a significant period of time.

Without incentives to build adequate reserves while maintaining benefits, many States will likely again implement actions which reduce the proportion of the unemployed receiving benefits. Thus, the present system is operating in a way which fails to encourage the States to take action to build reserves during periods of economic expansion.

Rather, the system depends heavily on Federal borrowing during economic downturns, requiring transfers from general revenues to the UI program.

We believe the Congress should take action to improve the adequacy of the UI system reserves.

Numerous alternatives are available to the Congress. These include requiring the Department of Labor to establish and enforce adequacy standards, providing financial incentives to States that have adequate reserves, raising the Federal tax in order to build reserves, and probably a wide variety of other creative approaches that could be taken.

One caution, however, is that any effort to improve the financial condition of the UI system is going to create this pressure to again cut benefits to the unemployed. So I think Congress should also consider whether or not it wants to concern itself with that or if it should make any changes.

Mr. Chairman, that concludes my prepared statement of myself and my colleagues.

We are here to answer questions if you have any.

[The statement of Mr. Gainer follows:]

GAO TESTIMONY BY WILLIAM J. GAINER ON UNEMPLOYMENT INSURANCE ISSUES RELATING TO RESERVE ADEQUACY AND TRUST FUND SOLVENCY

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to share with you some preliminary results from GAO's analysis of major issues facing the federal-state Unemployment Insurance (UI) system. In particular, I will discuss the increasing incidence of trust fund insolvency -- meaning states exhaust their trust fund reserves and must obtain federal loans to pay benefits to unemployed workers-- and the declining adequacy of UI trust fund reserves --adequacy meaning that states have reserves sufficient to pay benefits during economic downturns without becoming insolvent. We have analyzed trends in trust fund reserve balances and recipiency coverage, the causes of these trends and the projected impact on trust fund reserves of future recessions. Our major conclusions are as follows:

- Since the mid-1970's the overall national system has faced an increasing problem of trust fund insolvency. States have eeded billions of dollars in federal loans to continue paying benefits to the unemployed.

- Many state UI trust funds are not currently maintaining reserves sufficient to pay benefits during the next recession without multi-billion dollar borrowing from the federal government.

- If a moderate recession occurred in 1988, the number of insolvent trust funds would likely more than double from 7 to 17.

- Even if the current economic expansion continues into the 1990's, trust fund reserves are expected to remain inadequate.

- A variety of federal policies, such as charging interest on federal loans to states and employer penalty taxes, have increased the costs of insolvency to state programs. These policies have likely encouraged some states to avoid short term insolvency, but have not resulted in the accumulation of adequate reserves. However, they have caused states to reduce benefit costs by reducing the duration of benefits and tightening eligibility standards, thereby contributing to the decline in the proportion of the unemployed receiving benefits.

Unless states change their funding practices, future recessions will likely exacerbate the pattern of the early 1980's with states needing large federal loans to pay benefits and, in an effort to regain solvency, states again reducing the proportion of workers receiving benefits. This proportion has declined from nearly one half during the 1950's, to less than a third in the 1980's, and in October of this year, only 26 percent of the unemployed received benefits.

BACKGROUND

The UI system is the federal government's major means of providing income maintenance assistance to the unemployed. The system's primary objectives are to provide employees with temporary and partial insurance against income loss resulting from unemployment and to assist in the counter-cyclical stabilization of the national economy during economic downturns. In 1986, the trust funds of the 50 states, the District of Columbia, Puerto Rico and the Virgin Islands paid about $16.4 billion to more than 8.5 million unemployed workers and collected about $22 billion in employer taxes and interest.

ADEQUACY OF TRUST FUND RESERVES

To determine whether state trust fund reserves are being maintained at levels sufficient to pay benefits during times of increased unemployment, GAO examined trends in the most commonly

used measure of financial adequacy, known as the "High Cost Multiple" which compares current reserves to peak historic benefit payouts. (See table 1) In the past, the Department of Labor recommended that states voluntarily adopt a standard for the high cost multiple of 1.5, and state employment security agency administrators also sanctioned a 1.5 multiple as indicative of reserve adequacy. Although the arithmatic is somewhat complicated, this standard is equivalent to requiring that reserves be available sufficient to pay recession-level benefits for one and a half years. GAO found that in 1986 the aggregate High Cost Multiple for state funds was only .44 -- meaning that reserves on average were sufficient to pay benefits for only about 5 months, which is much shorter than recent recessions that have averaged about 12 months.

As for individual trust funds, 39 states had adequate trust fund reserves in 1969 (meeting the 1.5 standard), but only 2 states had adequate reserves in 1975 (See figure 1). As of 1986, only Mississippi and South Dakota had funds considered to be adquate. Although a standard of 1.5 is now considered by some to be too conservative, even if a more lenient 1.0 standard is used, current reserves are still inadequate. Using the 1.0 standard, only 11 state funds were found to have adequate reserves in 1986, down from 51 in 1969. Thus, while only 8 states were insolvent in 1986, 34 solvent states were maintaining inadequate levels of trust fund reserves using the 1.0 standard.

Table 1 -- ADEQUACY OF TRUST FUND RESERVES

- o States Need to Maintain Reserves Sufficient to Pay Benefits During Recessions
- o Current Reserves are Insufficient
  - Funds' Ability to Pay Recession-level Benefits Have Declined
  - In 1986 Reserves Were Equivalent to 5 Months of Recession-level Benefits
  - Recessions Average 12 Months
- o Inadequate Reserves Have Resulted in Large Federal Loans to Pay Benefits
  - 23 Trust Funds Insolvent in 1983
  - Federal loans of $7.8 billion in 1983

When fund reserves prove inadequate to meet benefit payments, states may borrow from the federal government. In 1969 no state was insolvent. The recessions of the 1970's and 1980's caused an increase in insolvency with, for example, 23 state trust funds insolvent in 1983. In 1986, despite several years of sustained economic growth, 8 state trust funds remained insolvent. Until very recently most trust fund insolvency was concentrated in states in the midwest and northeast. The recent difficulties in energy and related industries has created solvency difficulties to Texas, Louisiana and other energy producing states.

Solvency and Adequacy of State UI Trust Funds 1969-86

IMPACT OF RECESSION ON SOLVENCY

The UI trust fund reserve has increased from a negative balance of $5.8 billion in 1983 to an historic high of $15.4 billion in 1986, as a result of the extended period of economic growth following the last recession. However, despite this increase in reserve growth, the financial health of many state trust funds is vulnerable to a downturn in the economy.

Projections from the Department of Labor's UI system model predict that if strong economic growth continues through 1992, trust fund reserves will increase, although adequacy will not improve significantly. Aggregate reserves will grow by 62 percent to an estimated high of about $25.2 billion in 1990, yet despite this growth, the High Cost Multiple improves only marginally -- to .45 from .44. This occurs primarily because revenue growth is expected to be just marginally greater than the growth in covered workers.

We also used the Labor model to analyze the possible impact of a moderate recession in 1988 equivalent to the average of the last 5 recessions. While this analysis is subject to the kind of uncertainty associated with any projection of the future, the simulation shows that the financial condition of the UI system could be expected to deteriorate rapidly. The number of insolvent states could more than double from 7 to 17. Even assuming a recovery in 1989, 17 trust funds would remain insolvent in that year, requiring federal borrowing of $1.9 billion in 1989.

To further illustrate, even a trust fund considered to be in good financial condition is vulnerable to recession. We developed a simulation model of the Massachusetts state trust fund, which has almost $1 billion in reserves and a High Cost Multiple of .61. Under favorable economic conditions, its trust fund reserves will grow more slowly than increases in total workforce payrolls and its financial adequacy will, therefore, deteriorate. Projections predict that the fund would avoid bankruptcy during a moderate recession in 1991, although reserves would be reduced to under $100 million. Under current funding practices, the state's fund would become insolvent in a major recession in 1991 (as its high cost multiple portended), requiring an estimated $800 million in federal loans and remain in debt for at least five years.

CAUSES OF INCREASED INSOLVENCY

Several factors have contributed to the UI system's general decline in solvency, including the high unemployment generated by 3 major recessions since 1970 and the tendency in many states for increases in benefit expenditures to exceed UI revenue growth. (See Table 2 for a summary.)

- The American economy's weak performance since 1970 has eroded trust fund solvency. Repeated recessions and economic growth lower than necessary to generate sufficient employment growth in many states have led to higher overall unemployment during the 1970's and 1980's.

- Higher unemployment rates increase UI costs by increasing the number of claims and hence the benefit payments. For example, unemployment in the 1960's averaged about 4.8 percent, compared to 8 percent thus far in the 1980's. In addition, higher unemployment levels are often associated with greater numbers of high wage workers being laid off, also increasing average weekly benefits.

- The 1980's have exhibited higher rates of long term unemployment --an increase of 90 percent since the 1970's. Such increases lengthen average benefit duration, thus raising outlays.

o Twenty state programs have indexed benefit levels to inflation but have not indexed their state UI taxes, causing benefit expenditure increases to outpace revenue growth.

o Extended benefits, as provided under the Federal Employment Security Amendments of 1970, also have contributed to state trust fund financial difficulties because states did not increase revenues to finance their portion of the additional 13 weeks of benefit payments allowed.

Table 2 -- CAUSES OF INCREASED TRUST FUND INSOLVENCY

o Higher Unemployment Since 1973 Increased Benefit Costs

- More Workers Received Benefits
- More Higher Wage Workers Received Benefits
- Long Term Unemployment Increased

o Benefit Payouts Increased

- Many States Tied Benefits to Inflation
- Revenues Not Indexed
- Extended Benefits Not Funded

FEDERAL POLICY ON INSOLVENCY HAS CONTRIBUTED TO REDUCED WORKER BENEFITS

During the 1980's the Congress enacted a number of provisions which, in essence, make it more expensive for states to exhaust their reserves and borrow from the federal government to pay benefits. To avoid penalties for insolvency or qualify for financial incentives to improve solvency, states were required to cut benefit costs or increase taxes, or both. (See Table 3 for a summary). Actions taken at the federal level include:

-- the charging of interest on federal loans to insolvent trust funds which, prior to 1981, were interest free,

-- enforcing so called "penalty taxes" on employers in states that have not repaid their loans in a timely manner, and

-- providing financial incentives --such as reduced interest rates, the deferral of interest payments or reductions in employer penalty taxes-- to states that have taken action to both reduce benefit expenditures and increase program revenues.

Table 3 -- FEDERAL POLICIES CONTRIBUTE TO REDUCED BENEFITS

POLICIES:

- o Penalty Taxes to Delinquent States Enforced (1980)
- o Interest Charges on Federal Loans to States (1981)
- o Incentives for State Solvency Improvements (1983)

STATE RESPONSE:

- o Eligibility Requirements Tightened
- o Benefit Duration Reduced
- o Weekly Payments Reduced

Although these policies have encouraged states to eliminate existing trust fund debt, as noted earlier, states have not

accumulated adequate reserve balances. As of 1986, only 3 of the 31 trust funds which had been insolvent at least once since 1972 (Alabama, Hawaii and Maryland) had regained reserves sufficient to achieve a 1.0 High Cost Multiple.

Reducing benefit costs has, in turn, often meant decreasing the proportion of the unemployed receiving benefits. GAO identified numerous changes in state UI laws during the 1980's which had this effect. Some examples are:

- Since 1981, 6 of the 8 states which had maximum benefit duration exceeding 26 weeks cut them back to the 26 week maximum used by other states.

- 35 states increased the earnings level required for minimum weekly benefits, while 18 states changed their eligibility requirements to reduce the number of unemployed receiving benefits.

- 19 states increased the disqualification penalties for claimants who quit work without good cause, 22 states increased penalties for claimants dismissed because of misconduct, and 20 states increased penalties for claimants who refused suitable work while unemployed.

CONCLUSION

To sum up, despite the recent accumulation of what may appear on the surface to be significant reserves, the UI system remains financially fragile. The number of trust funds with adequate reserves has declined and is likely to increase only moderately even if the economy remains strong. Meanwhile, individual trust fund insolvency has increased dramatically and despite the length of the current economic expansion, seven state trust funds remain insolvent today. Economic projections suggest a significant increase in such insolvencies in the event of another recession, with inadequate reserves leading to increases in borrowing from the federal government to pay benefits.

Without incentives to build adequate reserves while maintaining benefits, many states will likely again implement actions which reduce the proportion of the unemployed receiving benefits. This proportion has declined from nearly half the unemployed during the 1950's to less than a third during the 1980's. In October of this year the proportion of the unemployed receiving benefits was only 26 percent, nearly a record low.

Thus, the present system is operating in a way which fails to encourage states to take action to build reserves during periods of economic expansion. Rather, the system depends heavily on federal borrowing during economic downturns, requiring transfers from general revenues to the UI program.

The Congress should take action to improve the adequacy of UI system reserves to minimize the number of state trust funds becoming insolvent during economic downturns and help avoid multi-billion dollar borrowing from the federal government. Numerous alternative actions are available to the Congress to improve the adequacy of trust fund reserves including, requiring the Department of Labor to establish and enforce adequacy standards, providing financial incentives to states that have adequate reserves, or raising the federal tax to build reserves. Efforts to improve the financial condition of the UI program could result in a reduction in the availability of benefits to workers, therefore, Congress also should be mindful of the need to maintain appropriate levels of worker benefits.

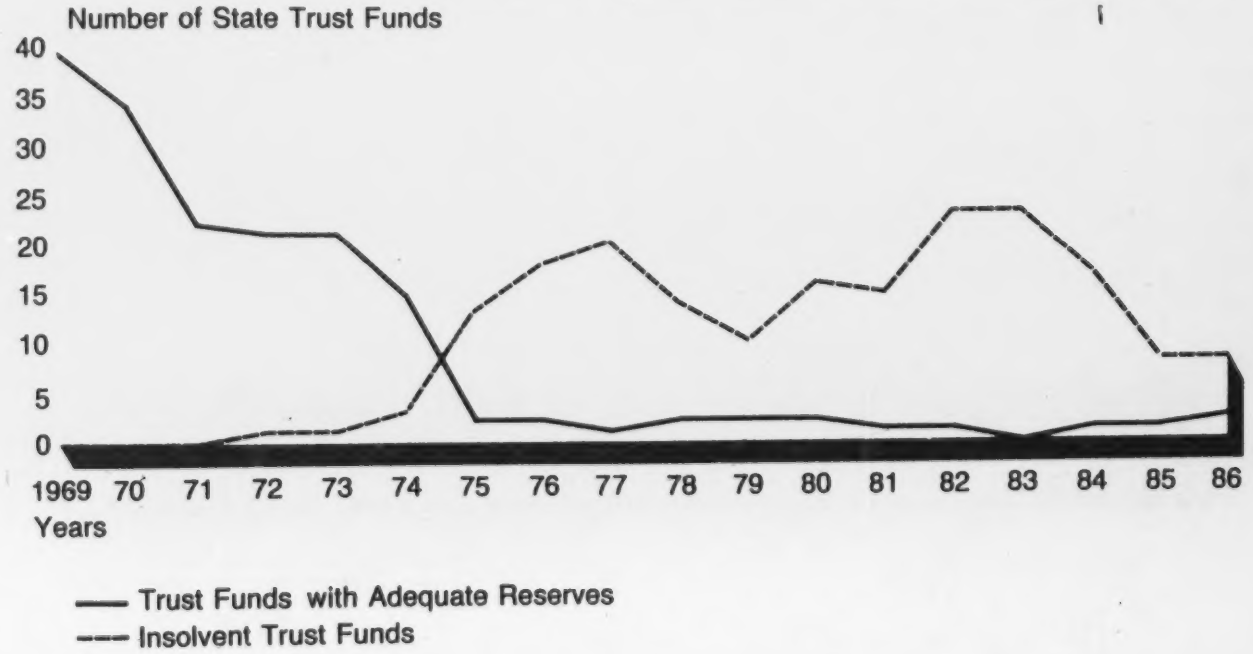
GAO

Adequacy of Trust Fund Reserves

- Reserves Should Be Sufficient To Pay Benefits During Recessions
- Current Reserves Are Insufficient
  - — Adequacy Has Declined
  - — 1986 Reserves Equal to 5 Months
  - — Recessions Average 12 Months
- Federal Loans Required
  - — 23 Funds Insolvent in 1983

GAO

Adequacy and Solvency of State UI Trust Funds, 1969 to 1986



GAO

Causes of Increased Trust Fund Insolvency

- Higher Unemployment Since 1973 Increased Benefit Costs
  - More Workers Received Benefits
  - More Higher Wage Workers Received Benefits
  - Long Term Unemployment Increased
- Benefit Payouts Increased
  - Many States Tied Benefits to Inflation
  - Revenues Not Indexed
  - Extended Benefits Not Funded

GAO

Federal Policies Contribute To Reduced Benefits

Policies

- Penalty Taxes To Delinquent States Enforced (1980)
- Interest Charges on Federal Loans (1981)
- Incentives for State Solvency Improvements (1983)

State Response

- Eligibility Requirements Tightened
- Benefit Duration Reduced
- Weekly Payments Reduced

Acting Chairman DOWNEY. Secretary Jones, can you tell me in your opinion—Mr. Frenzel has advanced this view and others have too—about whether the more we extend benefits and the more we improve benefits, the more likely there are people who will want to receive them.

Could you tell me if that's your view or this administration's view? Does this reflect the world as it is?

Mr. JONES. Mr. Chairman, that's a question over which we have long had dialogues and discussions, not only in this program but several other benefit payment programs. There is—I think at the bottom of it we all have to recognize—not substantial data on the subject. We do have some. Our general view is that the higher or longer the benefit that is provided, it does in fact have an effect of encouraging people to stay on the system longer and then move off only at the end of it. And there are two or three indications of that.

We did have a study of the FSB program by Mathematica which estimated that the existence of FSB increased the average length of unemployment experienced by UI beneficiaries by at least 2½ weeks over what would have occurred otherwise.

There is another study that dealt only with two States, unfortunately, during the 1980–81 period that traced some of the behaviors. One of the interesting things shown during that period was that a much higher proportion of the people returned to work in the 4 weeks after exhaustion than either in the later periods or in the earlier periods. The contrast was about 14 to 16 percent reemployed 5 to 8 weeks after exhaustion and 10 to 14 percent reemployed 9 to 12 weeks after exhaustion. And about 40 to 50 percent of the exhaustees of both regular and UI extended benefits were reemployed within the immediate 4-week period.

So there are some indications that that's the case. We also have some studies over in the TAA area and some others that would demonstrate the same kind of behavior. I still would not say that this is national substantial data.

Acting Chairman DOWNEY. Have you suggested any change in the level of protection that we provide in extended benefits? I think the testimony was that based on the conditions prevailing at the time, we should wait until we have a recession to determine whether or not we should be doing something about it.

It seems to me that that's one of the classic criticisms of the Congress. We wait until a crisis is upon us to deal with a problem. We're all thankful for the long recovery, and it seems that we're really in a golden position to do something to protect ourselves from the next inevitable recession.

Is there in your mind anything that we should be doing to deal with extended benefits before the next recession?

Mr. JONES. Mr. Chairman, I think you're right. We'd like it both ways.

I think your reason for the hearings to be held and the discussion to examine issues during a period of relative calm in the system is good and a good time to do it. It's a good discussion and good to examine a number of these things—to determine what behavior might result if in fact we have any number of types of

changes in the system down the road. So we would applaud that side of it.

The problem on the other side, of course, is that if we jump to the conclusion that therefore we need to immediately put in stopgap measures for any potential contingency that might exist, it creates two perverse kinds of results.

One—perhaps socially the most damaging—is that whatever program you create may not in fact meet the needs of the individual causes of whatever downturn occurs, either by industry or geographical concerns or individual State concerns or whatever. And the other is the enormous costs, as we stated earlier in our testimony, of investing a substantial amount of tax dollars—State, Federal, or whatever—in a potential system that we don't yet know or understand. And that has an impact on the economy as well as employers and other kinds of behaviors in and of itself.

Where does the line land between these two things? I don't really have an adequate answer. I think it's a fair question that you ask, however.

Acting Chairman DOWNEY. You listened to Mr. Gainer's testimony. What about the simple question of the adequacy of the trust funds and the fact that there is a disparate situation: the States that are most likely to need it are in the worst shape. When we encourage them to pay back, we charge them interest, and they are likely to reduce the benefits of the very people who need the most help.

It sounds like it was done by a committee.

Mr. JONES. I don't take issue with Mr. Gainer's explanations of either the status or the prospects of the system generally. Again, this is an issue that has plagued people for some time. The basic taxation authority that exists in this system is within the States—as is the benefit determination system and the eligibility determination system—and it is very difficult, I think, even for the Congress, as you point out, in a clear, noncommittee fashion to set some kind of a Federal standard in one area without addressing all of them. And that would be a fairly substantial shift in the unemployment insurance system as we have known it in this country.

The behavior described here, as you probably recognize, has occurred from this period in the early 1980's up to now as a result of earlier problems in the system that occurred from the last recession.

So we've already moved through one set of dialogues trying to figure out how to respond to a draw on that system. And this is what resulted from it.

I think it is probably not punitive. It is a fairly normal response of a State manager to look down the road and anticipate a situation in which the draw on his State may be as bad as it was back in the 1970's and therefore be a little more concerned, both about eligibility and benefits.

Whether or not that's directly caused because of the interest payments or some other things that we're yet unsure of—that's why we have the current study—or whether it's caused just because of the impact on the loan itself and everything else, I don't know.

But to predict, again, a standard Federal requirement means that we need to know something about each of those States, each of

the eligibilities, each of the benefits, and the taxation rates. That's generally not been an acceptable approach either to us or to——

Acting Chairman DOWNEY. Yes. Well, let's talk about that just for a second.

I'm going to ask in advance James Madison's forgiveness for putting this question to you, but it strikes me that the people who are unemployed—in Louisiana—have a lot less to do with decisions made in Baton Rouge—or the people who are unemployed currently in Houston with the decisions made in Austin, Tex. but rather are there as a result of problems that affect the whole country. In other words, unemployment is a uniquely national phenomenon.

There might be some consequences that result from State actions. But the oil price decline—that has hurt one part of our Nation and helped another part of it.

Why should we put the State of Louisiana and the State of Texas the State of Ohio in a tougher position to deal with this question than the State of New York or the State of New Hampshire, who have benefitted from greater import-export?

Mr. JONES. Well, I'm not sure I go quite as far as you do, but certainly you're right—that we're experiencing a growing impact on local unemployment of national and international trends and impacts. And to some extent, that part is absolutely true. The problem here is that the revenues you and I are sitting here discussing and spending aren't ours; they're State-generated. They're generated in those local areas from businesses and employers, and benefits are drawn in those local areas, by and large.

And still—as Mr. Pease and I have discussed on a number of occasions—to this day, people don't move. In spite of programs for relocation funding, they are still in Louisiana and Texas, even in the midst of the blight that they have experienced.

And the systems of benefit payments—even extended benefit payments in part, anyway—are being generated and paid for by those employers in those areas. People are going to go back to work, largely, in those same areas, with some exceptions. Whatever experience we have tends to suggest that's the case.

Acting Chairman DOWNEY. I had the fortune or misfortune of spending a long time in an airplane, and the only magazine left was the Economist, which I usually don't read.

They had an interesting survey—market survey—of the Scandinavian countries. And what struck me as I was thinking about this hearing was the view that the Swedes take, which is a little bit impossible but perhaps more what I would like to see.

They just don't pay scheduled benefits for that long. They just make sure that people are trained. There is a much greater sense of the national community.

Now, I understand that there are important questions of homogeneity and the size of the country—but it strikes me as a sensible thing at some point to make extended benefits something more than extended benefits—that we're not just going to pay money ad infinitum so some people can stay home in a recession but that there might be some skill or some function that we could provide for them that would make some sense.

Mr. JONES. There are two different points I would make.

One is that we still are faced with the same dilemma here of whose resources we're spending for what and what laws we want to put in place, either for Federal general revenues, as it is in Sweden and many European countries, or local revenues.

But more important than that, conceptually, I think you're right. Part of Mr. Pease's and Mr. Levin's and others' bills here are directed at how to begin to make these benefits, no matter who pays them, more usable for individuals in returning to the labor market at an earlier point and investing in training, relocation, or other kinds of things.

There is no question that—I think earlier Congressman Pease pointed out many of the people that he is concerned about are folks that aren't going back to work in their indigenous industries. And that is in fact the case, it's true.

It's also just as true, I think, that long-term unemployment benefits aren't going to do anything other than continue them in whatever status that is. The transition these people have to participate in and to undertake is a painful but real one. And the faster we can get them into training—we have raised the question, as you probably know, in our worker adjustment bill—that training begin even in the basic 26 weeks.

It starts to look interesting to try to get people in the latter half of that period into training at the soonest possible point.

Our demonstration list would go on to include such things as—maybe we ought to talk about wage help and other kinds of assistance that get them back into that stream faster.

So conceptually, we would agree with you.

Acting Chairman DOWNEY. Thank you.

Mr. Gainer, let me ask you a couple of questions—one, about this dilemma that I posed to Mr. Jones about the States making payments back to the Federal Government by charging them interest, which results in their diminishing unemployment benefits.

What, if anything, should the Congress do to prevent that or is it something that we should think about?

Mr. GAINER. Well, I think this is a Federal-State program. It's not a State program, and it's not a Federal program.

The Federal Government sets a fairly significant list of requirements on State programs in order to be an acceptable program and get the tax credit and so on.

So I don't see that either a guideline on adequacy of reserves or some kind of guideline on benefits, if Congress could work out a formula for trying to ensure that there was some minimal level of benefits—I don't think either is really out of the question, given the history of this program.

Acting Chairman DOWNEY. You mention a recession using up reserves in 5 months in some places. Can you give me a sense of what type of recession we're talking about and how deep is the recession?

Mr. GAINER. To give you some idea on—in the case of the 5 months that I mentioned, what we are talking about is the so-called high-cost multiple of 0.44, which is the average calculated for all the State funds. So that would be enough, on average, for 5 months of benefits.

In each case, the high-cost multiple for a State is developed based upon the worst recession that State has had. And it's a—you look in that year—the worst recessionary year that that State had—in many cases it's 1975 for some of the States. In some cases it's 1983.

In each case, you can calculate that number and see how long those kind of benefits would last. So in essence, the 0.44 is based on something similar to what happened in 1975 or what happened in 1983.

You had unemployment rates in 1975 that got up above 9 percent, I think, nationally. Some State unemployment rates probably were into the midteens.

And of course, I'm sure you remember something a little more carefully about what 1983 was like.

Acting Chairman DOWNEY. Let me state—before I turn this over to Mr. Pease and Mr. Frenzel—that the reason we're having this hearing is that—aside from Mr. Pease's leadership on this—the reality is that in the global economy in which we find ourselves, the State and local and national system may need to be changed. We welcome your expertise and interest on this.

I think now is the time to do something about it. We rarely get a chance to breathe when unemployment is high, and now is the time to act.

Mr. Pease.

Mr. PEASE. Mr. Gainer, I don't have much by way of questions for you, but I think your testimony has been very valuable.

And I hope if there is any press available that they will take away your message that the next time we have any kind of a deep recession at all, we're going to have a flock of States running out of money very soon—after 5 months, you say—and borrowing billions of dollars from the federal system.

Is that a fair summary of what you said?

Mr. GAINER. The circumstances would differ for each State. But you would have in a recession maybe 15, maybe 20, maybe 25 States, depending on the circumstances that occurred.

But I think it's clear that given the reserves that are now being carried, any kind of recession is going to run some number of States into Federal borrowing, and it's going to cost money.

Mr. PEASE. Let me turn for a minute to your recommendations for dealing with this inadequate reserve situation.

You say a number of actions could be taken, including requiring the Department of Labor to establish and enforce adequacy standards. Presumably that means that instead of 0.4 or something or other, you'd make it 1.0 or something or other and say in the deal that you must require the States to increase their local taxes in order to fill that.

Is that what you have in mind?

Mr. GAINER. I don't think I'd want to advocate a specific number at this point.

I used the 1.0 as an illustration because it would likely provide reserves in any State adequate to get them through kind of an average recession.

Mr. PEASE. A 12-month recession?

Mr. GAINER. Yes.

Whether you need more than that is unclear to us at this time. But I think that kind of standard—even though some feel it's too simple; it must be more complicated than that—I think that sort of standard would tend to hold up over time.

And I think the Department could implement in a way that it provided flexibility, depending upon the revenue system in the State and the benefits system in the State. For example, if a State were able to have a mechanism where their taxes automatically went up in a recession, which you may wonder if that's a good idea. But if they had that mechanism, I think the Department could say that under these circumstances, perhaps a lower reserve would be adequate.

Mr. PEASE. Well, requiring DOL to establish standards and enforce them is not an incentive. That's a fairly heavy-handed decision on our part.

You mentioned also providing financial incentives to States that have adequate reserves. Could you elaborate on what you have in mind?

Mr. GAINER. Well, what you have now is an incentive just to avoid insolvency but not to build reserves. The incentive in this case is an interest rate, for example.

I suppose that you could put in a differential interest rate on what you pay States on their reserves, depending on how adequate that reserve was. Maybe pay a little less than you pay now for an inadequate reserve, a little more as it reaches adequacy, and so on.

Mr. PEASE. Okay, that's a useful suggestion.

Mr. Jones, let me turn to you. I'll talk first of all about demonstration projects.

You indicate that you're not eager to have Congress pass my fine legislation, H.R. 2676, because you already have demonstration projects underway.

Can you give me an idea of how the demonstration projects you currently have underway match up with what we envision in our legislation? Are all of those bases covered, or half covered, or what?

Mr. JONES. I'll ask Ms. Golding to answer that for you.

But a majority of those bases are covered, and I would point out the one thing that we are talking about here is not just because we are doing it but the issue of how they are paid for. Our proposal here is that we continue to demonstrate those kinds of issues even if we haven't covered them all.

We would be happy to discuss that with you to continue to try to do it out of general revenues before we spend trust fund money on what we know may or may not work or have any impact. That's really the other half of the issue.

Ms. GOLDING. I think in terms of types of activity in your bill, I believe we have at least one demonstration for each of them and in some cases, with the exception of self-employment, multiple demonstrations.

Mr. PEASE. Do you have one going for sub-State triggers?

Ms. GOLDING. We have a study going for sub-State triggers—a research study, not a demonstration.

Mr. PEASE. Would it make you feel better if we just emphasized what I think the bill already says, and that is that we are providing authority to provide demonstration projects—that we don't

mandate them so that if you felt that you've got some already underway that respond to the areas, you wouldn't be required to conduct them and you could use your authority elsewhere where you felt it was appropriate?

Ms. GOLDING. I think that would make us feel better.

I think there are some other provisions that we'd like to talk to you about too—which go to the funding and which complicate the demonstration mode substantially—that I think we'd like to see altered as well.

Mr. PEASE. You're talking now entirely within the demonstration area?

Ms. GOLDING. In the demonstration areas.

Mr. PEASE. Well, by all means share with me what your concerns are.

I'm a little puzzled. You're speaking, I gather, for the administration? The OMB has cleared your testimony?

Mr. JONES. Yes, it has.

Mr. PEASE. I'm a little puzzled.

Mr. Chairman, you'd be interested in this. We have a welfare bill on the floor tomorrow which the administration is opposing because it doesn't provide for enough demonstration projects. And here we are trying to encourage demonstration projects, and the administration is opposed to this bill because of that.

Are you authorized to explain inconsistencies in administration position?

Mr. JONES. Authorized or willing?

Mr. PEASE. I think you have to be authorized before you're willing.

Mr. JONES. I haven't found too many people authorized to explain the inconsistencies.

But I don't know that that's an inconsistency. I think that, as you well understand, the issue in the welfare debate is not just demonstrations. It's demonstrations versus a substantially increased cost in an expensive mainline program—which ought to come first.

And I think here the thesis is the same. We are suggesting in your bill, rather than lay on these demonstrations from trust fund money on a mainline basis, that we would do it from general revenues until we know what's going on.

I think the thesis is the same. It may not come out quite the same.

Mr. PEASE. I see.

Well, can we count on you then—the Department of Labor—to seek funds in your next budget to carry on adequate demonstration projects out of general revenue funds?

Mr. JONES. We have been continuing to do that, and I can assure you that that will stay a very high priority in anything we do.

We think the issues that the committee has addressed, and your bill has addressed, are absolutely valid and important issues.

Mr. PEASE. Good.

You note in your testimony that the administration opposes the EB portion of this legislation on the grounds of cost—I can understand that—administrative complexity—and because "we are opposed to establishing legislation and a new program before we see

the scope and scale of the unemployment problem it's designed to address."

I would like to address those latter two reasons for your opposition.

The administrative complexity—in a period of high unemployment, you would be administering the EB program with different States triggering on at different times and triggering off. You would also, if past recessions are any guide, be trying to administer an FSC program as well.

And as I recall from 1983 and 1984—1983, really—we were complicating your life considerably by adjusting FSC and trying to have you try to explain to the States when a person is eligible for EB and when for FSC and why one and not the other and so on.

Can you explain to me why the sort of combined program that Mr. Clinger and I are proposing in this legislation which would combine EB and FSC in the one program with differential costs and benefits and trigger points—why that would create more administrative complexity than the present system?

Ms. GOLDING. The Inspector General for the Department of Labor has recently done a study on Federal share programs, which covered the extended benefits and Federal supplemental compensation program as it operated during the last recession.

And one of the things that created the most problems was State laws being conformed to the EB provisions. That drove the largest pot of money, which they questioned.

There was a succession of FSC changes. And the States had to cope with those, generally speaking, on a relatively short-term basis.

However, I think it is a tribute to the States' ability and commitment to operating the program well, that they apparently managed to cope with that succession of changes very well with a high degree of accuracy.

The difficulties seemed to be, among other things, exactly interpreting the intent of the Federal language and getting it into a permanent State code in a way that did not do violence to that intent.

What you are proposing here is that kind of change—an EB program that would have to be conformed in State law by a date certain to exactly fulfill the Federal requirements. It would become the subject of a conformity and compliance issue—a very different situation from a general revenue, Federally authorized program in which the States act as our payment agent.

Mr. PEASE. Let me just state for the record, Mr. Chairman, that it's difficult for me to believe that the program that we are advocating could even approach in administrative complexity either for DOL or the States what went on during 1982 and 1983 under the EB/FSC provisions.

And I think we need to think some more about what the States have to do—State legislatures—to jump through hoops to address the problems we thrust upon them when we put an FSC program on top of EB and expect them to get the benefits out in a couple of months.

You can have philosophical questions about whether the Federal Government ought to be imposing any requirements on the States or whether you ought to just give them the money and let them

run it or, better yet, require them to raise the money and spend the money—we get out of it altogether.

That's the Department's approach. Assuming for the moment that Congress doesn't do that, then we're left with a Federal mandate to the States to conform their laws to a Federal law.

And what we're saying is it's better now, while unemployment rates are still relatively stable, to spend the next year or 18 months or 2 years conforming it. And then when you do that, you will know that this is how it works. If your TUR is 8, 9, or 10 percent, this is the effect, and you'll know how much matching money you'll get, you'll know the length of duration of benefits you have to pay to the beneficiaries, and so on.

And I think the argument that you make that you want to see the scope and scale of the unemployment problem just reinforces my point that if we wait 1 or 2 years to see whether the unemployment rate is 8, 10, or 12 percent in the next recession, then we can't make any changes which anticipate giving the States a year or 1½ or 2 years to conform their laws.

We're going to have to say, "You do it in the next 2 months if you want to get the benefits." Isn't that correct?

Ms. GOLDING. I think your point that you have to look at the administrative impact and the impact on State law and legislation is a well-taken one—one that we would certainly agree with.

Mr. PEASE. I think even OMB would be sensitive to that point.

Well, I want to turn next to your testimony where you're talking about the cost of the legislation. You talk about a recessionary scenario with an IUR of 4.3 percent and a TUR of 8.6 percent.

Costs would be $4.2 billion compared with current law costs of about $2.2 billion and that additional cost would be split up—perhaps two-thirds Federal and one-third by the States. Two-thirds Federal would be about $1.3 billion of Federal money involved to implement this program in a recession—in the scenario that you point out.

I recall during 1982 and 1983, we were passing FSC bills with a cost of $1.5 billion for each one, one after the other—extending them. So I look at this and say that this program is unlikely to cost any more or maybe not as much as the current law if you assume that Congress will respond, as it has in the last couple of recessions, with an FSC program in a period of high and rapidly growing unemployment?

Ms. GOLDING. What we did to arrive at those figures was to forecast the beginning of the recession as if it were occurring in 1989.

And what we concluded was that the total cost to the States and to the extended unemployment compensation account and the Employment Security Administration account would total $4.2 billion. The split on that would be about $1.3 billion to the States with the remainder of $2.9-plus to the two Federal accounts.

We could, if you would like us to, forecast how that would play out over the recession and compare that to what was actually laid out under the old law.

Mr. PEASE. Sure.

Well, I just want to emphasize for the record that when you talk about $1.3 billion for the States and $2.7 billion or whatever for the Federal Government, that is the total cost.

What I was talking about is the marginal cost of a new program above and beyond the existing law program.

Ms. GOLDING. It's true. FSC was only in place for a few months. It just came on at the end of 1982, which was the year we used as the pickup.

Mr. PEASE. Well, I'd appreciate it if you would do your calculations for the remainder of that period.

I want to ask about your recommendation. The administration proposed the legislation to require transfer of authority and responsibility for administering unemployment insurance to the States.

Am I correct? The administration is proposing the transfer of the whole ball of wax to the States? What is your proposal?

Mr. JONES. No, sir. We introduced earlier in the session a piece of legislation which transferred to the States a significant number of administrative decisions made currently in the system and the basic operation funding of the administrative account, but not the trust fund portion of the system.

We have not transferred or block-granted the whole process. It is euphemistically known as a list of administrative reform types of issues. But we do think it would provide more flexibility and response in such a system.

Mr. PEASE. Okay. I'll have a look at that.

Do you know who introduced the bill for you?

Mr. JONES. It was in the major comprehensive bill—I don't recall the number—the Omnibus Trade Bill, when it was first introduced back in February.

But we'll send you a copy.

Mr. PEASE. Send me a copy of that, if you will.

Mr. JONES. Yes, sir.

Mr. PEASE. Concerning Mr. Frenzel's points earlier about paying the same amount of extended benefits in each State that qualifies—without looking at what it takes to qualify for unemployment payments under a State's laws, are you aware of a wide variation among the States on how easy or difficult it is to qualify for State unemployment compensation?

Ms. GOLDING. We do have a list of how State laws vary by that eligibility criterion, which we would be happy to supply.

There is some variation. Some States use a period of work to qualify. Some use the amount of wages spread over a period of time.

There is some variation, although many States have enacted changes since the early 1980's.

Mr. PEASE. Would you describe that as a wide variation or some variation or a narrow variation?

Ms. GOLDING. Some variation.

Mr. PEASE. Some variation. I figured you might feel like that—answer B.

Ms. GOLDING. Answer B—that's right.

Mr. PEASE. Finally—and I appreciate the Chair's indulgence—Mr. Frenzel raised the point productively, as he often does in these hearings, about whether longer unemployment benefits encourage people to stay on the system longer, whether you might think

about a system of declining benefits the longer people are on and so on.

In a hearing we had on this bill last year in 1986, I tried to focus some attention really beyond my own legislation now to the problem of structural unemployment and the fact that unemployment periods are getting longer and longer, a lot of workers are not going back to their original jobs, and so on.

And my concern was that we have a sort of cliff effect—that after unemployment compensation—26 weeks now in every State—the worker who has been working for 20 or 25 years for XYZ Corp., which moves its plant out and closes it altogether, chooses not to move, as you point out, has difficulty being retrained because there aren't very many jobs in the community.

If that worker falls over a cliff—goes from being eligible for $200-some a week or whatever it is for unemployment benefits to being eligible for nothing until he's eligible for welfare. And that is until he runs through his family's entire assets—gets down below $1,500 to qualify for welfare. And I can tell of you a lot of workers who come in to me saying—who faced that exact situation.

I want to know whether the DOL feels that it is part of its role to exercise leadership, as we go into a new economic situation, to think about those new kinds of circumstances and make recommendations to Congress. Is that your role? Have you done that, and do you have any thoughts?

Mr. JONES. We think that's very much our role, Mr. Pease.

And I think it's clear under the leadership of Secretary Brock and now—imminently—Secretary McLaughlin that we will continue to pursue that particular issue with great vigor.

Chairman Downey points out correctly that a good deal of what's happening to people in Ohio and in every part of the country is not just a localized issue. It's very much international or national in scope and frequently has something to do with financial markets or things that people have very little impact on.

We introduced directly as a result of that the worker readjustment program—a billion-dollar program.

I would send to you, by the way, the estimates on that program, which were designed effectively on a mathematical model across the country to provide substantial readjustment services to everyone who we think would be in need of them outside of normal systems, all of which is beyond the basic UI system.

Secondly, a part of that program was designed to link directly into the unemployment insurance system. The cliff issue you raised we think is a very important one, but the way to address it is not to extend benefits ad infinitum. It is, in fact, to bring people into that training loop at an earlier stage. And we have been quite open as to exactly how or when to do that.

But we think to not get people aware and in that cycle earlier is really a disservice to them. Our New Jersey model on the unemployment insurance system itself is a bonus system and a retraining system during the 26-week cycle.

So we have done a number of things, and you can look forward during the next year or two to our continuing to work on those issues.

I think we have now moved from strictly a structurally unemployed issue to a system where we are all recognizing that working-level Americans and their adjustment is as much a part of our policy as disadvantaged or long-term unemployed people are.

Mr. PEASE. I would be happy to yield.

Acting Chairman DOWNEY. Mr. Jones, on that point, would you tell us briefly some of the other States that are involved in demonstration programs?

Mr. JONES. New Jersey, Pennsylvania, and the State of Washington at the moment I think are the three.

Mr. PEASE. Mr. Chairman, that concludes my questions.

I'd like to thank Mr. Jones for his testimony and reiterate my interest and willingness to work with you and my anticipation—eager anticipation—of hearing the results of your continuing studies on the problem of structural unemployment and getting people back into the loop sooner.

Thank you.

Acting Chairman DOWNEY. Bill?

Mr. FRENZEL. Thank you, Mr. Chairman.

I thought Mr. Pease was going to thank me for waiting.

Mr. Chairman, there are at least four subcommittees of this committee meeting today.

Could you give us an idea of what the subcommittee is going to do from here on out? Are we going to hear through lunch, or are we going to break?

I do want to get up to the CBI hearing.

Acting Chairman DOWNEY. Bill, it was my intention to work through lunch.

Mr. FRENZEL. I thank you.

I thank both of the gentlemen for their testimony.

I notice, Secretary Jones, that you did not mention any research or demonstration on the subject of sub-State trigger areas. You have not done anything and do not contemplate doing anything?

Mr. JONES. No, Mr. Frenzel, that is not true.

We have a study underway on sub-State triggers. We had earlier done a study and provided it to the Congress on the issue itself on a nationalized basis.

We now have a study underway examining the feasibility of using sub-State areas for the payment of the benefits and what kind of a system that might look like—specifically how to, if you will, design sort of a mockup model of what the system would be, and then use that to turn back and answer with some greater precision our continued contentions that technically it is very difficult from a data standpoint and a system standpoint, and to try to assess those with a little bit more specific insight than we have had to this date.

It's an 18-month study, and it should be completed early in 1989.

Mr. FRENZEL. Thank you very much.

When Mr. Pease was claiming that his bill might be cheaper than the current program, I think you should have made a deal with him that he guarantee to do no more in his bill because whenever we get into the difficulty of high unemployment, hero medals are cheap around here.

I thank you for your testimony.

Mr. Chairman, I note that the questions raised to the secretary were not shared with the minority staff on the committee. And I hope in the future that when we query agencies of the Government, unless there is something essentially secret or strategic in the rules, that we can play too.

And I hope that we'll have some more questions to lay on you before long.

Mr. Gainer, do you have an ongoing operation in your agency which follows unemployment compensation?

Mr. GAINER. We're doing a fairly significant study now which this work is part of. And we anticipate doing some further work on the solvency question after we report on this particular topic in—probably a little after the first of the year.

In addition to that, we have been asked by the Appropriations Subcommittees to look at the impact of the administrative cost cuts on service at the local level.

Mr. FRENZEL. Are you doing your report at the request of this subcommittee?

Mr. GAINER. No, sir, we're not.

That was started on a self-initiated basis, although we were aware of a number of pending bills on UI reform and had talked to a variety of committee staffers who expressed interest and thought that UI work would be useful.

Mr. FRENZEL. Is it customary for your agency to self-initiate studies like that?

Mr. GAINER. It is. In the past we initiated a lot more of our work on a self-initiated basis.

Currently, though, the work of the agency is running at something above 80 or 85 percent congressional. And in my area, which is employment and education, I think this may be the only self-initiated piece of work we have right now.

Mr. FRENZEL. I see.

When do you expect to complete this report?

Mr. GAINER. We have a draft of the study now, and we hope to send it to the Department of Labor for comment in January.

Mr. FRENZEL. You have not contacted the Department of Labor up until now?

Mr. GAINER. We've worked with a variety of people at the Department of Labor in getting data, and they did some of the simulations for us that we based some of our calculations on.

Mr. FRENZEL. I hope so. We can't afford two departments.

I hope you are using their work effectively and not duplicating their efforts.

When you talked about adequacy and solvency, your statement seemed to presume a 12-month recession.

Mr. GAINER. The 1.0 standard that I mentioned is based on the fact that that's been the average of all the recessions we have had since 1949.

Mr. FRENZEL. Then how do you define a recession?

Mr. GAINER. Well, in terms of the particular calculation that we use for adequacy—namely, the high-cost multiple—it's defined in terms of the most severe recessionary year that any one of the States experienced. So the high-cost multiple you calculate for

Ohio, for example, would be based on the worst recessionary year that that State experienced.

Mr. FRENZEL. And have you determined what you think is an adequate reserve now? Is that the amount necessary to carry a State for twelve months?

Mr. GAINER. We looked at this from a variety of points of view and generally used standards that have been used by others, such as associations of State UI directors, the Department of Labor, and so on.

The chart that I have over here was based on a high-cost multiple of 1.5, and that has been used for years a measure of solvency.

I said that—now there is some question as to whether 18 months of recessionary reserves are really needed, and so I used the 1.0 as an illustration of a less stringent reserve requirement.

Mr. FRENZEL. Have you drawn any correlations between size of the trust funds and the increases in benefits?

You will recall that when the Congress thought Social Security trust funds were large in the late 1960's and early 1970's, we sprayed out the benefits like drunken sailors.

What has been the experience with UI?

Mr. GAINER. We have not looked at it in just that way.

I think, though, that in fact as adequacy has gone down—the adequacy of the reserves has gone down—the maximum benefits have increased kind of as a long-term trend over the last 20 or 25 years.

The maximum benefit paid by States has generally increased while the adequacy has gone down, so I guess the two really don't seem to be correlated.

Mr. FRENZEL. I'd like you to take another look at it, if you can spare some of your vast resources, and scan those statistics.

There is a problem when States get run down by high unemployment. The States are least able to attack the problem when unemployment is high.

Mr. GAINER. True.

Mr. FRENZEL. Employers characteristically avoid taking on new employees. Unemployment compensation payments are a jobs tax, in a sense.

I think we have to look at this far more carefully than we have done, and I hope that your draft is more detailed than the short version you have been able to give us today.

Mr. GAINER. It is, in fact, quite detailed and looks at the whole variety of measures of adequacy. It looks at—in some detail at what a number of States have done in terms of changing their laws to respond.

And it's a little weightier than some of the people who have to review it would like it to be.

Mr. FRENZEL. Is the State of Minnesota one of your debtors?

Mr. GAINER. Not at this time, sir. They have been borrowers in the past.

Mr. FRENZEL. Thank you, Mr. Chairman. I yield.

Acting Chairman DOWNEY. I thank the two witnesses for their testimony. The subcommittee at this time will hear from the Interstate Conference of Employment Security Agencies, Inc.; the Ohio Bureau of Employment Services; William L. Heartwell, Jr., execu-

tive vice president, ICESA; Massachusetts Division of Employment Security, Sally Ward; State of Florida, Hugo Menendez, secretary of the Florida Department of Labor and Employment Security.

Before the subcommittee hears from this panel, I'd like to recognize Bill Heartwell for the 10 years of distinguished service that he has rendered at ICESA. I understand that he is retiring, and I want to pay homage to your fine work.

Bill, why don't we commence with you?

Mr. HEARTWELL. I'll defer to Ms. Kilbane.

STATEMENT OF GRACE KILBANE, DEPUTY ADMINISTRATOR, OHIO BUREAU OF EMPLOYMENT SERVICES, ACCOMPANIED BY WILLIAM L. HEARTWELL, JR., EXECUTIVE VICE PRESIDENT, INTERSTATE CONFERENCE OF EMPLOYMENT SECURITY AGENCIES, INC.

Ms. KILBANE. Thanks, Bill.

Mr. Chairman and members of the subcommittee, my name is Grace Kilbane. I am deputy administrator of the Ohio Bureau of Employment Services.

Today I am speaking on behalf of the Interstate Conference of Employment Security Agencies, or ICESA.

ICESA, as you know, is the organization of State administrators of unemployment compensation laws and public employment offices throughout the country. We appreciate the opportunity today to address the issues related to unemployed workers.

In the notice announcing this hearing, a series of questions was posed. I would like to address these questions and comment on portions of H.R. 2676 and H.R. 3213.

In addition, I would like to call to your attention the serious administrative funding problems that are currently facing the unemployment insurance system.

The first question: Do States have sufficient reserves in their unemployment funds?

During the 1970's and the 1980's, the solvency of State unemployment funds have been a serious problem. As stated before, the debt was up to $23.4 billion and it is now down to $2 billion.

The guidelines developed by ICESA many years ago suggest that reserves should be sufficient to cover 18 months of high unemployment. According to the latest data available from the Department of Labor, only two States—Mississippi and South Dakota—have this level of reserves in their trust fund. Language in Ohio law would have us at $2.2 billion to be at minimum safe level of reserves.

So I suppose that our response would be, "no", we do not believe that there are sufficient reserves in the trust funds.

The second question: Do existing programs provide adequate coverage of the work force?

There is no doubt that there is a smaller percent of all unemployed individuals today who receive unemployment benefits than was the case 10 years ago. However, there are many reasons for this, and they're not entirely clear and need further study.

Among the explanations that have been offered by researchers are increases in the number of long-term unemployed due to eco-

nomic dislocation, increases in new entrants and re-entrants to the labor force, tighter qualifying and eligibility requirements, and cutbacks in extended benefits and Federal temporary benefit programs.

Whether adequate coverage is being provided is a question that must be answered ultimately by us and the public.

In considering this question, it is important to keep in mind that the unemployment insurance program is designed to deal primarily with cyclical unemployment, to provide temporary income maintenance between jobs to those unemployed for reasons related to the season or business cycle.

We would argue that the UI system should not serve those without recent participation in the labor force. To do otherwise would change the entire character of the program.

However, the UI system may be able to address potential long-term unemployment by identifying early those who are likely to exhaust benefits and referring them to appropriate assistance.

The State of New Jersey, as has been mentioned before, is currently doing some demonstration projects in addition to the other States that have been mentioned.

I think there are several proposals in H.R. 2676 that are directed toward the long-term unemployed.

In title II of the bill there is a demonstration project to promote training for individuals receiving unemployment compensation. This proposal would require participating States to approve training for any UI recipient whose prospects for reemployment would be improved by training, require the Department of Labor to evaluate implementation of the provisions, and credit all benefits paid to individuals participating in training against any interest owed on Federal loans.

Speaking for the State of Ohio, which has paid $250 million in interest on Federal loans, I think it's a great idea to use that cost to leverage it against training or credit it somehow against training programs.

As drafted, this proposal would apply to all UI recipients, not just dislocated workers or others who might have difficulty returning to work.

The question could be asked whether it is appropriate for UI benefits to provide income support for workers with marketable skills who wish to pursue a new field. And I think that that's a question we need to ask while we're looking at this bill.

Title IV of H.R. 2676 would provide additional resources to State employment service agencies to provide assessment, testing, and counseling services and instruction in job search techniques to unemployed individuals who are unlikely to return to their former occupation.

Due to reductions in funds for employment services over the past several years, States have been forced to drastically cut back these exact types of services, making additional funds sorely needed. These services should be linked with the unemployment insurance system with the intention of providing services early in the individual's period of unemployment.

We would definitely support that—particularly, I think, the linkage because all of the other programs that have dealt with dislocat-

ed workers or the long-term unemployed have not been mandated to link with the unemployment insurance system, which is the first place that all dislocated workers come.

The third question: Would the current Federal-State extended benefits program provide the additional protection needed during a period of high unemployment?

As you know, prior to 1981, extended benefits were paid under the same terms and conditions as regular State benefits.

Beginning in 1981 with Federal requirements related to suitable work and work search, numerous Federal qualifying and eligibility requirements have been imposed. These requirements have all had the effect of restricting benefits payments.

During the recession that was subsequent to these changes, Congress found it necessary to enact a temporary program of Federal supplemental compensation, or FSC, which paid additional benefits to all States—not just those where extended benefits were available. This seems to indicate that Congress did not perceive the extended benefits program to meet the need that existed at that time.

Since then, there have been several legislative proposals to revise EB and blend it with elements of the Federal supplemental compensation program.

H.R. 2676 is now before this subcommittee, and ICESA supports a number of the basic concepts of this bill, which I'd like to highlight now.

One of the basic concepts that ICESA supports is that there is a variable number of weeks of benefits which would be available based on the level of unemployment in the State.

The second concept is that there would be a sliding scale of financial responsibility between the State and Federal Governments. The higher the level of unemployment, the greater the Federal share. This makes a great deal of sense.

The third major concept is there would be a similar sliding scale between Federal Unemployment Tax Act revenues and general revenues in paying for the Federal share. Again, the higher the level of unemployment, the larger the general revenue contribution.

Even though ICESA supports these basic concepts, we have some concerns about the costs which would be created from the trigger of benefits. These costs would come at a time when regular benefit outlays would be very high and would likely contribute toward further borrowing from the Federal Government.

We are also concerned about several aspects of the mechanisms that would trigger the payment of extended benefits such as the seasonal adjustment of the insured unemployment rate and the use of the total unemployment rate as an alternative trigger.

This is a concern because it is an estimate. It is an estimate based on a relatively small sample in most States and consequently has a large error rate, resulting in wide month-to-month fluctuations.

So I think the proposal has merit and we need to study it further. We need to be careful that these fluctuations won't cause instability within a State and also inequities among States.

Title II of H.R. 2676 provides for demonstration projects in three States to administer the revised extended benefits program on the basis of unemployment in sub-State areas.

Each time that sub-State triggers have been considered in the past, the desirable effect of targeting benefits to areas where they are most needed has been outweighed by the practical problems of developing a feasible and fair method to do so.

We would encourage, rather, to modify the bill to permit States that participate the flexibility to experiment with the sub-State trigger design in an attempt to develop a feasible method. In Ohio we would be looking at, according to the bill, population areas of 250,000, which is equivalent to about 30 areas.

The fourth question: Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions in these programs that have been enacted in recent years?

As an economic stabilizer, we believe that the unemployment insurance system continues to function well during periods of high unemployment. Even during high unemployment periods, the majority of UI recipients do not exhaust all of the benefits to which they are entitled.

When high unemployment is cyclical, UI continues to be an effective economic stabilizer, so we would basically answer yes to that. However, when that high unemployment is structural, UI can only be a temporary stabilizer. So I guess our response would be that it depends on what kind of unemployment you are looking at.

The fifth question: Are there alternative uses of UC funds that could improve the efficiency of labor markets?

Again, we would look at the demonstration projects which are currently being operated in New Jersey, Washington, and Illinois that are testing such reemployment strategies as job search assistance, job search assistance combined with training or relocation assistance, and job search assistance combined with a cash bonus for early reemployment.

We would support these projects and encourage that demonstration projects continue to be funded. However, we support funding them out of general revenue funds versus trust funds. ICESA's position is that we should continue doing it that way before a law change is made to allow the use of trust fund money.

Finally, I'd like to close with the administrative financing issues.

In addition to the issues which are the subject of this hearing, we have serious concerns and serious problems with the current administrative funding of State unemployment insurance programs. Ample funds are collected through the FUTA tax—or the Federal Unemployment Tax Act—for the specific purpose of administering UI.

When any State, including Ohio, looks at all of the wonderful proposals that are contained in this bill, you almost have to look at it with fear because we know that we do not get funded to an adequate level to do the work that we are doing now. And whenever new programs come down the pike, we are expected to absorb them and perform the work. And at some point, there's just a real basic eroding of services.

So I suppose that our comments are somewhat tested by that fear, and I would give you that as a caveat to these comments.

Hopefully, in looking at the reforms we will be able to look at this as a very serious problem. The ICESA UI committee is looking at developing and devising a formula which we hope that you will look at later on this year.

This completes my prepared statement, Mr. Chairman.

Thank you for the opportunity to discuss these important issues.

[The statement of Ms. Kilbane follows:]

Statement by Grace Kilbane, Deputy Administrator
Ohio Bureau of Employment Services

Representing
Interstate Conference of Employment Security Agencies, Inc.

December 14, 1987

Mr. Chairman, members of the Subcommittee, my name is Grace Kilbane. I am Deputy Administrator of the Ohio Bureau of Employment Services. Today I am speaking to you on behalf of the Interstate Conference of Employment Security Agencies, Inc. (ICESA), and am accompanied by ICESA's Executive Vice-President, William L. Heartwell, Jr.

ICESA is the organization of state administrators of unemployment compensation laws and public employment offices throughout the country. We appreciate the opportunity to address issues related to the degree of protection provided by the unemployment compensation system to unemployed workers, especially during periods of high unemployment.

In the notice announcing this hearing, a series of questions were posed. I would like to address these questions and comment on portions of H.R.2676, the Extended Unemployment Insurance Act of 1987, and H.R. 3213, the Unemployment Insurance Reemployment Demonstration Act Projects Act, that relate to them. In addition, I would like to call to your attention the serious administrative funding problems facing the unemployment insurance system.

(1) DO STATES HAVE SUFFICIENT RESERVES IN THEIR UNEMPLOYMENT FUNDS?

In the 1970's and 1980's, solvency of state unemployment funds has been a serious problem. Wayne Vroman, in his book The Funding Crisis in State Unemployment Insurance, reports that 38 states borrowed $23.4 billion between 1972 and 1984. At the end of November 1987, only three states (Michigan, Pennsylvania, and Texas) have outstanding loans totaling about $2 billion. It is obvious that since the end of the last recession, many states have made tremendous efforts to repay federal loans. Only after loans are repaid can these states begin to build reserves for the next recession and begin to address the question of what is an adequate level of reserves. A guideline developed by ICESA many years ago suggests that reserves should be sufficient to cover 18 months of benefits during a period of unusually high unemployment. According to the latest data available from the Department of Labor, only two states, Mississippi and South Dakota have this level of reserves. Dr. Vroman concludes in his book that UI funding problems are likely to recur before the end of the 1980's and that they will be avoided in the short run only if there is no recession.

(2) DO EXISTING PROGRAMS PROVIDE ADEQUATE COVERAGE OF THE WORK FORCE?

There is no doubt that a smaller percent of all unemployed individuals today receive unemployment benefits than was the case ten years ago. However, the reasons for this are not entirely clear. Among the explanations that have been offered by researchers are: increases in the number of long-term unemployed due to economic dislocations; increases in new entrants and reentrants to the labor force; tighter qualifying and eligibility requirements; and cutbacks in extended benefits and federal temporary benefit programs. Whether adequate coverage is being provided is a subjective question that must be answered ultimately by the public.

In considering this question it is important to keep in mind that the unemployment insurance program is designed to deal primarily with cyclical unemployment, to provide temporary income maintenance between jobs to those unemployed for reasons related to the season or business cycle. We would argue that the UI

system should not serve those without recent participation in the labor force. To do otherwise would change the entire character of the program. However, the UI system may be able to address potential long-term unemployment by identifying early those who are likely to exhaust benefits and referring them to appropriate assistance. A cooperative demonstration project by the Department of Labor and the State of New Jersey to test early identification and reemployment strategies has shown some encouraging preliminary results. We would support additional demonstration projects and careful evaluation of the results before any changes were made to federal statutes that would permit UI trust funds to be used for any purpose other than benefit payments.

There are several proposals in H.R. 2676 that are directed toward the long-term unemployed. In Title II of the bill there is a demonstration project to promote training for individuals receiving unemployment compensation. This proposal would require participating states to: approve training for any UI recipient whose prospects for reemployment would be improved by training: require the Department of Labor to evaluate implementation of the provisions; and credit all benefits paid to individuals participating in training against any interest owed on federal loans.

As drafted, this proposal would apply to all UI recipients, not just dislocated workers or others who might have difficulty returning to work. Is it appropriate for UI benefits to provide income support for workers with marketable skills who wish to pursue a new field?

Currently any UI recipient who participates in training provided by a JTPA Title III program continues to receive benefits. Those who participate in other types of training may also be allowed under state law to continue to receive benefits. In general, it appears to us that training should be one of a variety of reemployment assistance available to potential UI exhaustees, early in their period of unemployment. The Interim Report of the New Jersey Demonstration Project tells us that only 14-16 percent of the group offered a wide variety of training opportunities were willing to participate.

Title IV of H.R. 2676 would provide additional resources to state employment service agencies to provide assessment, testing and counseling services and instruction in job search techniques to unemployed individuals who are unlikely to return to their former occupation. Due to reductions in funds for employment services over the past several years, states have been forced to drastically cut back these types of services, making additional funds sorely needed. These services should be linked with the unemployment insurance system, with the intention of providing services early in the individual's period of unemployment, rather than focusing the long-term unemployed or economically disadvantaged, as this Title provides.

(3) WOULD THE CURRENT FEDERAL-STATE EXTENDED BENEFITS PROGRAM PROVIDE THE ADDITIONAL PROTECTION NEEDED DURING A PERIOD OF HIGH UNEMPLOYMENT?

The extended benefits program is funded jointly by the states and federal government. The program operates under state laws that must conform with the Federal-State Extended Unemployment Compensation Act. Prior to 1981, extended benefits (EB) were paid under the same terms and conditions as regular state benefits. Beginning in 1981, with federal requirements related to suitable work and work search, numerous federal qualifying and eligibility requirements have been imposed. These requirements have all had the effect of restricting benefit payments. The elimination of the national trigger in 1981 and the increase in the levels of insured unemployment necessary for benefits to be available on a state-by-state basis in 1982 have also restricted extended benefit payments.

During the recession that was subsequent to these changes, Congress found it necessary to enact a temporary program of Federal Supplemental Compensation which paid additional benefits in all states, not just those where extended benefits were available. This seems to indicate that Congress did not perceive the extended benefit program to meet the need that existed at that time. Since then, there have been several legislative proposals to revise EB and blend it with elements of the Federal Supplemental Compensation program. One proposal by Mr. Pease, H.R. 2676, is now before this Subcommittee. ICESA supports a number of the basic concepts of the bill which are listed below:

- o A variable number of weeks of benefits would be available based on the level of unemployment in the state.
- o There would be a sliding scale of financial responsibility between the state and federal governments--the higher the level of unemployment, the greater the federal share.
- o There would be a similar sliding scale between Federal Unemployment Tax Act revenues and general revenues in paying for the federal share--the higher the level of unemployment, the larger the general revenue contribution.

Even though we support these basic concepts, our analysis indicates that the specific rates of unemployment which would trigger benefits would create substantial additional costs for states. These costs would come at a time when regular benefit outlays would be very high and would likely contribute toward further borrowing from the federal government by many states.

We are also concerned about several aspects of the mechanisms that would trigger the payment of extended benefits. The seasonal adjustment of the insured unemployment rate presents technical difficulties and does not seem to be necessary, given that a 13 week moving average is used and a requirement included for a percent increase over a prior period. The use of the total unemployment rate as an alternate trigger is also of concern because it is an estimate, based on a relatively small sample in most states and consequently has a large error range resulting in wide month-to-month fluctuations. These fluctuations could cause instability within a state and also cause inequities among states.

Title II of H.R. 2676 provides for demonstration projects in three states to administer the revised extended benefit program on the basis of unemployment in substate areas. Each time that substate triggers have been considered in the past, the desirable effect of targeting benefits to areas where they are most needed has been outweighed by the practical problems of developing a feasible and fair method to do so. You are undoubtedly familiar with the difficulties of obtaining the necessary data and of the inequities that could be created among unemployed workers in similar circumstances. We encourage you to modify the substate demonstration projects to permit states that participate flexibility to experiment with substate trigger designs, in an attempt to develop a feasible method.

(4) HAS THE STABILIZING EFFECT OF UNEMPLOYMENT COMPENSATION AND PUBLIC ASSISTANCE PROGRAMS DURING PERIODS OF HIGH UNEMPLOYMENT BEEN IMPAIRED BECAUSE OF REDUCTIONS IN THESE PROGRAMS THAT HAVE BEEN ENACTED IN RECENT YEARS?

As an economic stabilizer, we believe that the unemployment insurance system continues to function well during periods of high unemployment. Individuals receive up to 26 weeks of regular state benefits in most states, which gives communities and individuals a six month cushion of income maintenance during economic downturns when unemployment is high. Even during these

periods, the majority of UI recipients do not exhaust all benefits to which they are entitled. For those who do exhaust regular benefits, up to 13 weeks of extended benefits may be available, although these benefits are more restricted now than they were prior to 1981. In addition, Congress has acted to provide federal benefits during more lengthy recessions. When high unemployment is cyclical, UI continues to be an effective economic stabilizer; if high unemployment is structural, UI can only be a temporary stabilizer.

(5) ARE THERE ALTERNATIVE USES OF UC FUNDS THAT COULD IMPROVE THE EFFICIENCY OF LABOR MARKETS?

A number of projects are planned or underway to test proposals to use UI funds for purposes other than income maintenance or to coordinate income maintenance with other services. As I mentioned briefly, the Department of Labor and the state of New Jersey are cooperatively engaged in a demonstration project to test the ability of the UI system to identify potential long-term unemployed individuals and test the relative merits of three reemployment strategies: 1) job search assistance, 2) job search assistance combined with training or relocation assistance, and 3) job search assistance combined with a cash bonus for early reemployment. The interim report offers results positive enough for the Department of Labor to fund a similar demonstration project in the state of Washington. In addition, the Illinois Department of Employment Security has also tested reemployment bonuses and has had some positive results. In addition, I understand that the House-passed budget reconciliation bill authorizes self-employment demonstration projects for UI recipients.

The demonstration projects that would be authorized by H.R. 3213 appear to be patterned after the New Jersey and Washington reemployment projects, except that any state that participates would be required to provide an additional 30 weeks of benefits, the cost of which would be shared equally by the state and federal government. This requirement might make the cost of participation prohibitive in states with a relatively high population of dislocated workers, since those states typically have depleted their trust fund reserves in recent years.

It makes sense to us to test proposals for alternative uses of UI on a limited basis, using monies other than state benefit funds, before making changes to federal law that would require or encourage states to adopt them.

ADMINISTRATIVE FINANCING ISSUES

In addition to the issues which are the subject of this hearing, I would like to bring to your attention the serious problems of administrative funding of the state unemployment insurance programs. Although ample funds are collected through the Federal Unemployment Tax for the specific purpose of financing administration of UI and employment services, these programs have been subject to budget reductions brought about by overall concerns about budget deficits. In FY 1987, UI funds were reduced by $144 million, of which $50 million was subsequently restored in a supplemental appropriation. However, much damage had already been done. Many states, including Ohio, closed local offices, causing unemployed workers to travel longer distances for benefits and services. There were staff reductions in other states as well. It is true that fewer staff are needed when unemployment is low; however, a basic cadre of trained personnel and certainly a stable system of local service points, must be maintained in order to avoid chaos when unemployment levels go up again.

ICESA believes that the long-term solution to these administrative funding shortages is to remove the Federal Unemployment Trust Fund and state trust funds from federal budget totals, since these funds cannot be used for any purpose other than UI benefits and administration of UI and ES programs.

In the meantime, ICESA's Unemployment Insurance Committee is working to develop a proposal which would improve the administrative financing system, make it more equitable and less subject to the vagaries of the federal budget process. When we have progressed further we hope to have an opportunity to present these recommendations to you.

This completes my prepared statement, Mr. Chairman, thank you for this opportunity to discuss these important issues.

Acting Chairman DOWNEY. Thank you.
Ms. Burns.

STATEMENT OF PAMELA BURNS, DEPUTY DIRECTOR, MASSACHUSETTS DIVISION OF EMPLOYMENT SECURITY

Ms. BURNS. My name is Pamela Burns, and I apologize to begin with because I seem to have left my voice in Boston. I will try the best I can to make sure that you can hear me.

I am the deputy director for the Division of Employment Security in the Commonwealth of Massachusetts.

Today's challenge, it seems to me, is to build upon the national program's years of success and ensure that it is now prepared to meet the demands of a new economy—one scarcely resembling that of the 1930's.

Even in Massachusetts, with a 3.8 percent unemployment rate in 1986, 10 percent of the work force made use of the UI system. Forty percent of these 300,000 people needed the system as a public-sector bank, a place to turn for financial support during a short period of unemployment.

The other 60 percent had been permanently separated from their jobs and utilized the UI program, as well as the employment service as a system for readjustment. Responding to the needs of this diverse group requires that we rethink the structure of our unemployment insurance system, including the roles and responsibilities contained in the current Federal-State partnership.

In Massachusetts, we have recently brought the UI and ES systems, together with the training system into a jobs agency for the State. We are developing what we call opportunity job centers in our local offices, which are places that workers can turn to for a high degree of job seeking assistance, referral to ancillary services which many of them need, as well as interim economic support through unemployment insurance. The point of the opportunity job centers is to assist people toward economic self-sufficiency in the hope that they will not have to use the unemployment insurance system again.

Employers too receive special services in our opportunity job centers. Our one-stop shopping simplifies and systematizes access to a labor pool which in Massachusetts is shrinking.

In Massachusetts, where employment and training activity carries a long history of public/private partnership, we have developed eight principles which we believe provide a responsible framework for discussion as this Nation's lawmakers and service deliverers set out to review the system.

The most important of these are: The system must permit discretion for States so as to encourage local efficiency and experimentation and innovation.

Secondly, the system must ensure that each State maintain a UI trust fund solvency level. The solvency level should be specific to each State so that it reflects varying economic conditions. Our belief is that only funds above the solvency level should be available for use in alternative programs.

Third, the system must encourage a high degree of intergration UI, ES, labor market information, and the State and local training

network. This is critical. Only by tightly tying all of these together can we really create a reemployment system for an individual.

The system—fourth and lastly—must permit and encourage creative uses of UI resources so long as they foster employment stability or the reemployment of workers. New strategies for providing reemployment services, especially training to the disadvantaged, to the long-term unemployed, to dislocated workers, and to youth demand a more viable labor exchange system characterized by flexibility and responsiveness to the priorities mandated by both State and national policy.

The Levin-Pease-Ford bill, H.R. 2313, is an excellent step in this direction, calling for demonstration projects and new, innovative methods of facilitating rapid reemployment of dislocated UI recipients.

An employment security system built on these four principles will allow Massachusetts and other States to manage their own operational and benefit moneys rather than mandating that we abide by very stringent Federal guidelines that, in our feeling, prohibit efficient and creative management of administrative resources.

In response to your specific questions, I would respond with the following.

First of all: Do States have sufficient reserves in their unemployment funds?

It varies. The level of State reserves varies greatly from one State to the other and within one State over time. Presently, as we have heard, a number of States have negative trust fund balances and therefore outstanding Federal loans while others like ourselves—Massachusetts—have sufficient reserves to trigger the lowest possible tax schedule.

Yet we have come full circle. During the 1975 recession, Massachusetts bankrupted its trust fund and was forced to borrow $265 million from the Federal unemployment account—we have since paid back that amount.

As I previously stated, we believe that an effective UI system must require each State to maintain a trust fund solvency level but suggest that the level should be specific to each State's relative economic condition. And once achieved, excesses in that system should be used for enhancing employment stability hopefully in a way to expedite in the reemployment.

The second question you asked was: Do existing programs provide adequate coverage of the work force?

Clearly, the labor force has changed over the past several decades. Increasing numbers of new entrants, seasonal workers, and part-time employees have resulted in a situation in which nationally—from our figures that we get from the Labor Department—71 percent of the unemployed in August were ineligible for UI. In Massachusetts, this number was 37,000 out of 89,000, or 41 percent—considerably lower than the national average.

There is no question but that the changing demographics of our labor force require that we revisit the issue of coverage.

The third question was: Would the current Federal-State extended benefit program provide the additional protection needed during a period of high unemployment?

Although there are six States with total unemployment rates greater than 8 percent and three States with rates higher than 7 percent, none is currently eligible for the EB program. We believe that an Extended Benefit Program, which by definition is designed to help alleviate the extra burden of excessive unemployment should not be so restrictive that even States clearly in need do not qualify.

The fourth question: Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions in these programs that have been enacted in recent years?

If you believe—and I do—that one purpose of unemployment compensation was to counteract the sudden withdrawal of workers' wages from the local economy, then clearly the reduction in workers who are eligible has impaired the achievement of that goal.

And the last question that you asked; Are there alternative uses of UC funds that could improve the efficiency of the system?

Yes. The effectiveness of the unemployment insurance system will be greatly enhanced if States with trust fund reserves above the designated solvency level are permitted to utilize UI money to offer alternatives to our jobless workers.

We like to think of this in two different ways. The first involves uses that relate to the way in which an individual receives his/her unemployment compensation—questions around lump sum payments or being able to buy into on-the-job training by receiving the unemployment compensation in one way or another,

And the second pertains to uses which allow increased flexibility in administering the system, for example allowing a State to use administrative funds to run different types of retraining programs, for workers who might be ineligible for JTPA sponsored courses.

I'd like to thank you very much for allowing me to speak here today.

We commend you for the work that you are doing on this issue.

Thank you.

[The statement of Ms. Burns follows:]

STATEMENT OF PAMELA BURNS,DEPUTY DIRECTOR, MASSACHUSETTS DIVISION OF EMPLOYMENT SECURITY

We, in Massachusetts, have been looking forward to the opportunity to contribute to the discussion and debate surrounding the reform of the Unemployment Insurance system.

* * *

The U.S. Unemployment Insurance (UI) system, authorized by the Social Security Act of 1935, provides a crucial economic safety net for the nation's labor force and employer community. It assures that individual hardships potentially resulting during periods of short-term unemployment are lessened, and that the labor force is stabilized during periods of economic downturn.

Today's challenge is to build upon the national program's years of success and ensure that it is now prepared to meet the demands of a new economy, one scarcely resembling the world of the 1930's.

Even in Massachusetts, with a 3.8% unemployment rate in 1986, 10% of the workforce made use of the UI system. Forty percent of these 300,000 people needed the system as a "public sector bank," a place to turn for financial support during a short period of unemployment. The other 60% had been permanently separated from their jobs and utilized the UI program and the Employment Service (ES) as a system for readjustment into a labor market from which they had become dislocated. It is to respond to the rapidly changing employment and training needs of this 60%, our nation's dislocated workers, and to prevent this percentage from increasing, which requires that we rethink the structure of our unemployment insurance system, including the roles and responsibilities contained in the current Federal/State partnership.

New strategies for providing training to the disadvantaged, to the long term unemployed, to dislocated workers and to youths demand a more viable labor exchange system, characterized by flexibility and responsiveness to the priorities mandated by both state and national policy. The Levin-Perse-Ford bill, HR 3213, is an excellent step in this direction, calling for demonstration projects in "new or innovative methods of facilitating rapid reemployment of dislocated UI recipients."

Yet, today's system with its extensive federal requirements imposed on the state operated employment security agencies, through rigid financial control systems and planning requirements, severely curtails our flexibility to meet the needs of our unemployed. In fact, the present system essentially penalizes states for managing the UI system in a cost effective and time efficient manner.

As a result of these prescriptive policies and Congressional spending cuts, Massachusetts received only 65¢ for every dollar the state's employers paid into the system in 1986. Whereas, if we had had access to even 80¢ on every dollar, we would have received $8 million more in operational monies than we did in 1986.

In Massachusetts, under a reformed Employment Security system using existing UI and ES dollars, the state could offer a broader continuum of services ranging from self-service for the most job ready to training and support services for the more severely disadvantaged. Besides improved services for claimants and job seekers, additional resources would be freed for work with employers, including customized labor market information and in-house training services. Monies to administer the state's 38 job centers could more easily be shifted to reflect changing needs or to fund new employment and training initiatives.

These factors bring to the forefront the importance of a comprehensive reform of the nation's employment security system, encompassing its funding, taxing mechanisms, management, and missions.

In Massachusetts, where employment and training activity carries a long legacy of public/private partnership, we submit eight new principles, which we believe provide a responsible framework for discussion, as this nation's lawmakers and service deliverers set out to reform the UI system.

As one of the states which bankrupted its UI trust fund account in 1975, and rebuilt the trust fund and taxing structure from scratch, we are highly sensitive to the need to retain the financial integrity embodied within the current structure. It is this system which has protected, and must continue to protect, benefits for jobless workers.

In Massachusetts, maintaining a solvent and fiscally responsible Employment Security system has always been, and will remain, our foremost priority.

MASSACHUSETTS PRINCIPLES FOR UI REFORM

1. Maximize the discretion granted states in the management of their system so as to encourage local efficiency, experimentation, innovation, and the development of strategies and procedures appropriate to the needs of each state.

2. Require each state to maintain a UI Trust Fund solvency level. The solvency level would be specific to each state, so as to reflect each state's unique economic conditions and best protect the benefits of workers.

3. Provide access to federal resources to address national problems of unemployment, as they are from time to time manifested in particular industries. Also, through a "solvency insurance system," to provide fiscal resources for states facing catastrophic levels of unemployment.

4. Encourage a high degree of UI/ES/Labor Market Information program integration.

5. Permit and encourage creative uses of UI resources so long as they foster employment stability or the reemployment of workers, (as outlined, for example, in HR 3213: retraining allowances, reemployment bonuses, self employment allowances, relocation assistance, and economic adjustment allowances.)

6. Require the financing and operation of a public Employment Service in each state offering free services to job seekers.

7. Continue the federal role of ensuring basic program conformity and the maintenance of a coherent national system.

8. Maintain an efficient flow of labor market and other information among states, and the states and the federal government; facilitate inter-state claims; and encourage cooperation among states and the federal government on special services and programs.

Specifically, these principles address our, and other, concerns regarding solvency by:

1) Requiring each state to maintain a UI trust fund solvency level, and

2) Establishing a federal "solvency insurance system" to address national problems of unemployment as they are from time to time manifested in particular industries and also to deal with catastrophic levels of unemployment in the individual states.

We believe that these tenets--by guaranteeing greater flexibility in the system--respond to today's and tomorrow's challenges, but at the same time preserve the basic values inherent in a federal/state UI system.

An Employment Security system built on these principles will allow Massachusetts and other states to manage our own administrative and benefit monies, rather than mandating us to abide by stringent federal guidelines that prohibit efficient and creative management of administrative resources.

Please note: We will later submit for the record testimony relating specifically to HR2676 and HR3213. Due to the late date on which we became aware of today's hearing, we are insufficiently familiar with the proposed legislation to comment officially. For now, I will say only that the Commonwealth wholly supports efforts to increase the flexibility of the UI system both in terms of its financing and management (as mentioned above), as well as the extent to which it accomodates alternative uses. The demonstration projects proposed in HR3213 are entirely consistent with our recommendations.

In response to the specific questions outlined by the Committee, I submit the following:

1. DO STATES HAVE SUFFICIENT RESERVES IN THEIR UNEMPLOYMENT FUNDS?

   The level of state reserves varies greatly from one state to the other, and within one state over time. Presently, ten states have negative trust fund balances and therefore outstanding federal loans, while others--like Massachusetts--have sufficient reserves to trigger the lowest possible tax schedule. Yet, we have come full circle. During the 1975 recession, Massachusetts bankrupted its trust fund, and was forced to borrow $265 million from the Federal Unemployment Account. (We have since paid that amount back.)

   As I previously stated, we believe that an effective UI system must require each state to maintain a trust fund solvency level, but that the level should be specific to each state's relative economic condition.

2. DO EXISTING PROGRAMS PROVIDE ADEQUATE COVERAGE OF THE WORKFORCE?

   Clearly the labor force has changed over the past several decades. Increased new entrants, seasonal workers, and part-time employees, have resulted in a situation in which nationally 71% of the unemployed in August were ineligible for UI (4.9 million were not covered, out of a total 6.98 million jobless Americans). In Massachusetts this number was 37,000 out of 88,700, or 41%.

   There is no question but that the changing demographics of our labor force require that we revisit the issue of coverage--that we review the question of who, if not all unemployed, should be covered by our unemployment insurance system.

3. WOULD THE CURRENT FEDERAL-STATE EXTENDED BENEFIT PROGRAM PROVIDE THE ADDITIONAL PROTECTION NEEDED DURING A PERIOD OF HIGH UNEMPLOYMENT?

   Although there are 6 states with total unemployment rates greater than 8% (Louisiana is at 9.9%, and West Virginia at 9.1%, Mississippi at 8.9%), and 3 states with rates higher than 7% unemployment, none is currently eligible for the EB Program.

We believe that an Extended Benefit program, which by definition is designed to help to alleviate the burden of excessive unemployment, should not be so restrictive that even states clearly in need of the additional benefits do not qualify.

4. HAS THE STABILIZING EFFECT OF UNEMPLOYMENT COMPENSATION AND PUBLIC ASSISTANCE PROGRAMS DURING PERIODS OF HIGH UNEMPLOYMENT BEEN IMPAIRED BECAUSE OF REDUCTIONS IN THESE PROGRAMS THAT HAVE BEEN ENACTED IN RECENT YEARS?

Recent cutbacks in UI/ES administrative funds have served to exacerbate the problem of perverse incentives, built into the current system, and certainly hinder a state's ability to deliver services cost effectively.

Massachusetts was able to survive the 4.3% cut in 1986, and the 10% cut in 1987 only because our state's economy was sufficiently healthy to enable the Governor and Legislature to use state monies to accomodate much (though not all) of the loss in federal dollars. Had this not been the case, we clearly would have had to close offices and curtail services, just as other states were forced to do.

5. ARE THERE ALTERNATIVE USES OF UC FUNDS THAT COULD IMPROVE THE EFFICIENCY OF THE SYSTEM?

The effectiveness of the unemployment insurance system will be greatly enhanced if state's with trust fund reserves above the designated solvency level are permitted to utilize UI monies to offer alternatives to our jobless workers. In this way, we can increase the competitiveness of our citizens, and ensure that they remain trained.

As you know, there are currently a number of states which have been awarded demonstration monies to test alterntative uses of UI. The results of these strongly suggest that innovative, and early, intervention eases and hastens a jobless worker's transition from dislocation to employment.

We wholeheartedly support efforts to expand the number and scope of demonstration projects, which we expect will continue to confirm that flexibility in the use of UI dollars is both extremely important and very effective.

Among the alternative uses to UI we are considering in Massachusetts, are:

<u>TRAINING VOUCHERS FOR THE STRUCTURALLY UNEMPLOYED:</u>
As the structurally unemployed are frequently victims of skill mismatches, a voucher training program would provide job seekers with an opportunity to obtain training which matches their abilities and interests with existing job opportunities. Because these job seekers would have a work history, retraining for existing employment could be accomplished relatively quickly in order to meet pressing labor shortages. Through a UI Voucher Program, employed workers seeking skill upgrades or temporarily unemployed UI claimants, could participate in training programs allowing them to remain competitive in the ever changing economy. The voucher would be essentially a revolving door ticket to lifelong economic self-sufficiency, while at the same time meeting employers' needs for a versatile workforce.

SMALL BUSINESS START UPS: Early results of European efforts allowing the use of unemployment benefit dollars to help individuals capitalize or otherwise promote small business growth support the feasibility of low cost job creation for a qualified group of workers. Additionally, because small businesses generate a considerable number of jobs, entrepreneurial ventures might create opportunies not only for program participants, but also for other unemployed workers.

SUPPORT SERVICES FOR JOBLESS WORKERS: By responding to an individual's immediate barriers to work (for example, lack of affordable child care services or inadequate transportation arrangements) as well as more structural, acute obstacles (for example, lack of competency in English or other basic job skills) we can severely diminish the potential for future dislocation of our unemployed. In other words if we do not respond to an unemployed worker with solutions addressing both short and long term needs, we are providing only a temporary answer, one which does little to prepare that worker for the future.

Our goal in Massachusetts is to provide lifelong economic self-sufficiency for all of the citizens of the Commonwealth as efficiently and compassionately as is possible. Thus, the sooner we begin to examine new and responsible ways of delivering employment and training services to our citizens, the better off we will all be. We applaud the Committee for taking the time to examine what wa in Massachusetts consider to be a great untapped resource, the Employment Security system, and strongly encourage continuation of this dialogue.

Thank you.

Acting Chairman DOWNEY. Thank you, Ms. Burns.
Ms. Ward.

STATEMENT OF SALLY A. WARD, DIRECTOR, ILLINOIS DEPARTMENT OF EMPLOYMENT SECURITY

Ms. WARD. Thank you, Mr. Chairman.

I'm Sally Ward, the director of the Illinois Department of Employment Security.

Today I am here representing our Governor Thompson, who would have liked to attend and has testified many times before this subcommittee on UI issues—something he is very concerned about.

On the question of UI trust fund reserves, I would like to focus on the new law that Illinois put into effect and some of the changes that we have observed related to reserves.

On December 3, 1987, Governor Thompson signed into law unemployment insurance reforms that will maintain solvency of the Illinois UI trust fund, raise benefits to unemployed workers, and reduce UI taxes for Illinois employers by more than $400 million next year. At the same time, we will retain nearly $300 million at the end of this calendar year to begin our fund building.

At the signing, our Governor said:

> Senate Bill 484 is a model agreement for the nation. This landmark legislation contains major tax reforms, including a self-adjusting mechanism that will trigger automatic adjustments into the fund from both sides—benefits and taxes—if unemployment climbs and the existing fund cannot meet its requirements. These innovative controls will guarantee adequate funds for benefits without costly borrowing.

These legislative controls consist of a permanent fund-building component, a benefit freeze or reduction as well as benefit increases; also a tax increase or decrease, depending on the economic conditions within the State of Illinois.

If the economy in Illinois is such that there is a drain on the UI trust funds due to an increase in benefits, the State's employers will have a two-tenths percent retroactive midyear surcharge implemented to their tax rates to avoid borrowing from the U.S. Treasury to meet current obligations. This would be a cumulative two-tenths increase annually if necessary. Thus, Illinois employers will avoid the imposition of Federal penalty taxes.

In addition, a new State experience factor measures unfunded benefits in the previous year and allocates those costs in the immediate following year to all employers to help maintain solvency on a current basis.

Our Governor indicated that this is perhaps the most meaningful piece of legislation in his 11 years as Governor in Illinois because of the significance of this problem over the last decade in our State.

This historic package allowed Illinois on November 9, 1987, to make the final $569 million repayment of our unemployment insurance debt to the Federal Government. That debt peaked in 1983 at $2.5 billion. We are eliminating a potential $410 million additional penalty on our employers next year.

This legislative package addresses fundamental problems that have existed in Illinois' unemployment insurance laws for decades. The solvency legislation and the repayment of the debt proves that

Illinois or other States can enact fiscally responsible legislation to create and maintain solvent UI trust funds.

I tell you about what Illinois has done to stress that each State is unique and must have the ability to establish its own solvency standards because of the way that the taxes and benefits are defined under State law.

Illinois chose not to have multiple billions of reserve dollars out of the economy but rather to use these funds to build the State's economy and keep more people working. The new legislation will still allow for the trust fund to build modestly with automatic triggers if drastic action is ever warranted.

On the question of coverage of the work force, we believe that any consideration of a new federally mandated program to increase or decrease UI coverage should be well researched and debated because of the financial implications on the States.

Illinois' primary concern with adding new individuals who are not monetarily eligible for UI now is the immediate impact on the trust fund. Our legislation is designed to keep trust fund balances at a level sufficient to pay benefits of the currently insured unemployed but not to build up surpluses of the magnitude required to introduce new uninsured, be they new entrants, reentrants, or other components of the labor force.

More can and should be done to provide employment-related services to these uncovered segments of the work force.

Illinois' position on assistance to the unemployed not eligible for UI is a coordinated effort between Job Service and other State human service agencies charged with providing income assistance to such individuals. These agencies are also able to provide various forms of support to the ineligible unemployed and their families that employment security or UI cannot.

We will continue to provide employment services to economically dependent individuals such as recipients of general assistance, AFDC recipients, food stamp recipients, on and on. By integrating reemployment efforts at our department with preemployment support services of other agencies, we are dealing with this problem and putting people back to work in Illinois.

On the question of extended benefits, we do support the current extended benefits program and believe it has served a useful purpose. Combining EB and FSC components is something we would be interested in exploring further.

Agencies already charged with providing income assistance to the long-term unemployed should continue to do so in an integrated way. Coordination at the State level is essential for proper economic development, which will yield all of the States better prepared to deal with recession.

On the question of the stabilizing effect of the UI programs, in Illinois we have moved to combine our unemployment insurance and job service at the entry-level position, totally integrating all of those responsibilities to enhance the stabilizing effect of the UI system. We do not merely co-locate the people in a single office, but the programs and the staff and the services are truly integrated.

Benefits alone are no longer the answer. Waiting for rehire or jobs to return is not wise. The work force needs to actively seek re-

employment, and UI should be in the business of putting people back to work.

In promoting full participation of all members of the labor force, the mix of the programs as well as the level of government sponsoring those programs has resulted in the need to enhance cooperation and integration among programs to eliminate overlaps, gaps, and inconsistencies in order to provide better services to users.

Also in Illinois the demand for labor market information has grown substantially to support these programs. Information must be configured to assist the planning and evaluation of all educational/vocational training programs in order to better prepare individuals to participate in the labor force and measure their successes and in economic development initiatives to create or maintain jobs that will permit all of those who have prepared themselves to participate.

UI is the center stabilizer, backed by job service and labor market information.

On the question of alternative uses of benefit trust funds, we recommend a conservative approach to the use of benefits for training and entrepreneurial-type projects and suggest that we must examine the ramifications of this type of initiative in greater detail.

Demonstration projects are the appropriate way to go. Any use should result in some demonstrated fewer UI dollars being spent.

As a matter of fact, Illinois played a leadership role in allocating some of our governor's discretionary Wagner-Peyser dollars for such a demonstration project several years ago.

The Illinois claimant placement experiment resulted in very positive indications. We provided a $500 bonus—a small amount of money—to individuals who received full-time employment—and that was 30 hours a week or more—before their 11th week of unemployment insurance benefits. And that employment had to be maintained for at least a 4-month duration to be counted in our sample.

The results were that the average duration of unemployment insurance was reduced by 1.15 weeks. The cost of that reduction was a savings of $158 per claimant. That is a reduction of 6.4 percent compared to our control group.

The findings of our study were published in the September 1987 American Economic Review. And I would like to share those comments briefly with you:

> It is clear that the members of the experimental treatment groups experienced less unemployment than the randomly selected control group. Thus, we may unambiguously reject the hypothesis that the Unemployment Insurance Benefits System is only a benign or non-distortionary income transfer. The results reported here are the first experimental demonstration of this proposition, and we believe them to be quite convincing.

Finally, I would also like to offer comments on the administrative financing issues facing our system.

I believe that there is a need for attention to the topic and urge you all to consider this issue as well as you explore the other issues.

While States are currently responsible for about 90 percent of the costs of the system in the payment of regular unemployment insurance benefits, Federal taxes through the Federal unemploy-

ment tax finance the administration of our program—approximately 10 percent of the total cost of the system.

The expenditures, the appropriations, the allocations from those funding sources have a very direct impact on our ability to manage those trust fund dollars properly. And many times the administrative decisions that are made in the allocation of those dollars conflict with priorities of the States in the expenditure of those dollars.

We believe in Illinois that the only way to resolve these problems is to transfer the responsibility for the administrative financing of our system to the individual States. And we have been working with many groups in the country to develop proposals to consider acceptable ways of making this transition.

We would look forward to working with this subcommittee on this question as well.

I thank you very much for the opportunity to meet with you today and address these critical issues of concern to Illinois.

[The statement of Ms. Ward follows:]

TESTIMONY BY DIRECTOR SALLY A. WARD
[ILLINOIS DEPARTMENT OF EMPLOYMENT SECURITY]
FOR THE SUBCOMMITTEE ON
PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION COMMITTEE ON WAYS AND MEANS
[HEARING ON DECEMBER 14, 1987]

I am Sally A. Ward, Director of the Illinois Department of Employment Security. Mr. Chairman, I appreciate the opportunity to appear before your subcommittee today. During this historic 100th Congress, you have faced many issues which are now of concern to the State of Illinois. Illinois has been following these issues for several years. Governor Thompson had wished to testify today, but he had a schedule conflict. I am appearing on behalf of Governor Thompson.

UI TRUST FUND RESERVES

On December 3, 1987, Illinois Governor James R. Thompson signed into law unemployment insurance reforms that will guarantee solvency of the Illinois' UI Trust Fund, raise benefits to unemployed workers, and reduce UI taxes for Illinois employers by more than $400 million next year.

At the signing Thompson said "Senate Bill 484 is a model agreement for the nation. This landmark legislation contains major tax reforms, including a self-adjusting mechanism that will trigger automatic adjustments into the fund from both sides if unemployment climbs and the existing fund cannot meet its requirements. These innovative controls will guarantee adequate funds for benefits without costly borrowing."

These legislative controls consist of a benefit freeze and/or reduction as well as a tax increase and/or decrease depending on the economic conditions within the State of Illinois. If the economy in Illinois is such that there is a drain on the UI trust Funds due to an increase in benefits, the state's employers will have a 0.2 percent retroactive mid-year surcharge added to their tax rate to avoid borrowing from the U.S. Treasury to meet benefit obligations. Thus, Illinois employers will avoid the imposition of a federal penalty tax.

"With this legislation, our business climate can improve dramatically. Employer taxes are being reduced, and the successful negotiations leading up to this package have sent a clear message throughout the world that Illinois business and labor leaders cooperate for the betterment of both sides.

There is a place for adversarial relationships," Thompson said, "but when it comes to business climate issues, business and labor leaders in Illinois have proven themselves to be statesmen."

This historic package allowed Illinois, on November 9, 1987, to make the final $569 million repayment of the State's unemployment insurance debt to the federal government, eliminating a potential $410 million penalty levied on employers by the federal government. The Illinois debt peaked at $2.5 billion in 1983.

This legislative package addresses fundamental problems that have existed in Illinois' unemployment insurance laws for decades. This solvency legislation and the repayment of the debt proves that Illinois or any other state can enact fiscally responsible legislation to create and maintain a solvent UI Trust Fund. Each state is unique and must have the ability to establish its own solvency standards.

The answer to what is an adequate reserve in a State's UI Trust Fund varies from state to state. Illinois chose not to have multiple billions of "reserve" dollars out of the economy, but rather to use these funds to build the state's economy and keep more people working. The new legislation will still allow the Trust Fund to build modestly with automatic triggers when drastic action is warranted.

COVERAGE OF THE WORKFORCE

The gap between the unemployed receiving benefits and the total number of unemployed is wide -- only a third are receiving benefits. In Illinois, 32 percent of those unemployed in October 1987 received benefits. This figure is part of IDES work force data and is derived by dividing the total number of unemployed in Illinois by the number of Illinois claimants receiving UI benefits.

Illinois' primary concern with adding individuals who are not monetarily eligible for UI is the impact on the Trust Fund. Illinois' new legislation is designed to keep Trust Fund balances at a level sufficient to pay benefits to the insured unemployed, but not to build up surpluses of the magnitude required to introduce the uninsured into the system. Since Illinois recently repaid the last of its Trust Fund debt, incurring additional debt and interest payments at this time would be viewed negatively by the State and by business and labor interests. Increasing employer taxes is not feasible as Illinois' UI tax system has been cited in the past as a factor working against the State's economic development.

Illinois is also concerned with the impact of increased workload on administrative costs for the employment security programs. Given the present funding structure, sufficient funds may not be available to provide for the additional staff required for increased claims taking and follow up activities and for additional EDP requirements. Either additional funding would have to be provided from existing sources or new sources would have to be developed.

Furthermore, the impact of increased taxes would hamper the creation of new jobs in Illinois. Increased taxes would fall disproportionately on small to medium sized businesses, the primary job creators. Employers may decide to defer adding to their work force. Employers may leave the State or decide not to locate in Illinois, favoring areas with lower tax rates. The resulting job loss would primarily affect the very people this program is trying to help. In a tight labor market, entrants and reentrants, who are less likely to have recent work experience, if any at all, would be passed over more often in favor of better qualified workers. Therefore, they might also be expected to continue collecting UI benefits longer than the current average.

Illinois' position on assistance to the unemployed not eligible for UI is a coordinated effort between Job Service and other state human service agencies charged with providing income assistance to such individuals. These agencies are also able to provide various forms of support to the ineligible unemployed -- and their families -- that IDES cannot. IDES will continue to provide employment services to economically dependent individuals such as recipients of general assistance, AFDC recipients, food stamp recipients, the handicapped, youth who are wards of the state, ex-convicts and other job ready individuals receiving services from state human service agencies. By integrating reemployment efforts at IDES with pre-employment support services of other agencies, we are dealing with this problem and putting people back to work.

The causes for this gap are not well understood. For example, it is difficult to determine the extent to which various factors have contributed to the widening of this gap over the last several years. Have states restricted coverage to help restore solvency to their UI Trust Funds or are demographic trends the cause of the problem? US/DOL is currently working with a contractor to determine the answers to these and other questions. Policy decisions on this issue should be based upon the results of this study if it produces useful results.

EXTENDED BENEFITS PROGRAM

The EB Program is not currently triggered on in any state. Illinois takes a conservative view on extended benefits -- either through lowering the trigger or implementing it at the substate level -- because of the effect of additional benefit payments on the Trust Fund and on economic development.

Other considerations which must be explored further include:

- The effect of substate payments on the smooth administration of the UI Program. Would it have the effect of balkanizing the system, of creating a mini Interstate Benefit program internally?

- The difficulty in defining areas for benefit payment. Substate areas for which data are currently available are large enough that they might include both depressed and expanding economic areas. Smaller areas would be difficult to define because of the lack of data.

- The conditions under which benefits should be extended: Temporary high unemployment versus long-term unemployment in historically depressed areas.

- The length of time appropriate to pay "temporary job insurance;" at what point should extended benefits become extended income support of the type offered by human service agencies?

Illinois' position on extended benefits is that agencies already charged with providing income assistance to the long-term unemployed should continue to do so. For other than recessionary times, a coordinated State economic development plan designed to diversify the economy to withstand all but the severest of economic downturns and directed toward depressed substate areas will prove more beneficial in the long run than extended payments. IDES will continue to aid economic development efforts through delivery of labor market information and labor exchange services.

THE STABILIZING AFFECT OF THE UI PROGRAMS

In promoting full participation of all members of the labor force, the mix of programs as well as the levels of government sponsoring those programs has resulted in the need to enhance cooperation and coordination among programs to eliminate overlaps, gaps, and inconsistencies in order to provide better services to users. In Illinois the demand for labor market information has grown substantially and sufficient staff is required both in the field and at the Central Office to collect, verify, analyze and disseminate labor market information. Information must be configured to assist the planning and evaluation of educational and vocational training programs (to prepare individuals to participate in the labor market and measure their success) and economic development initiatives (to create or maintain the jobs that will permit all those who have prepared themselves to participate). IDES examples include:

- The Substate Employment Projections System

  This system provides estimates of growth in the major sectors of the economy which are used by a wide range of individuals and organizations. Projections by industry are forecasts of the number of persons expected to be employed in an industry. These data are often used by government agencies, area planning counsels, corporations and research organizations in preparing budget estimates, economic development and employment analyses, or as input to specific models that are of particular interest to them. Employment projections by occupation are forecasts of the number of persons expected to be employed in an occupation. This information is one of the more useful tools for career guidance, and education and vocational program planning. The data are frequently used by job counselors to help the unemployed seek work.

- The Employment Tracking System

  This System is a longitudinal database containing up to seven years of information on a person's employment, unemployment and Job Service contact history for persons who have participated in educational or job training programs in Illinois. The objective of ETS is to make available to all of Illinois' publicly funded employment and vocational training programs, all private not-for-profit training organizations funded under the Job Training Partnership Act, and to public educational institutions a database that will allow these agencies to assess the impact of their training programs on the persons they have trained.

- The Database for Illinois Businesses

  This project is a first cooperative effort between IDES and a consortium of major labor market information users including the Federal Reserve Bank, universities, city and state government and other nonprofit research entities. The primary function of the Database is to provide information which identifies the job-generation components in growth industries and declining industries and provide comprehensive business "birth" and "death" data for the assessment of the State's economic strengths and performance.

- The Applicant Retrieval System/Computerized Job Order Retrieval System

  To facilitate the job-matching process statewide, IDES installed two interlocking computerized systems in all of its consolidated offices. The Computerized Job Order Retrieval System (COJORS) is an on-line file search program that accesses employment openings listed with the Illinois Job Bank and the Interstate Clearance System, a national job bank. The Applicant Retrieval Systems (ARS) accesses the availability and skills of applicants for the state's employers.

IDES began redefining the Job Service role several years ago to better serve the variety of clients. IDES defined the workers to be served: the job ready. Funding cuts forced IDES to severely curtail many labor intensive services, including employment counseling for applicants other than those for whom counseling is mandated. Networks with other State and local agencies were developed to refer the non-job ready to supportive services; and vice versa, they refer job ready clients to us for placement.

IDES defined its primary customer -- employers -- and emphasized employer satisfaction. IDES quickened its response to employer job orders and improved the quality of its job match with the implementation of the Applicant Retrieval System and the Computerized Job Order Retrieval System. IDES uses the General Aptitude Test Battery with validity generalized scores to give employers a means to predict job performance.

IDES is participating in Region V's Job Service Resume System. The system, which has built a pool of professional, managerial and technical job seekers, demonstrates that Job Service handles more than low-skilled, unmotivated applicants. The number of agreements with employers which name IDES as their primary referral source have increased and the resulting job openings are not just low paid and entry level. Many employers realize that hiring the best qualified individuals for jobs will ultimately save them money by improved job performance which will minimize terminations, voluntary or otherwise, and keep down their UI costs. For example, IDES was selected to fill all 2,900 job openings at the new Diamond Star Motors plant and is assisting many of the feeder industries with their recruitment.

IDES defined the services it will provide: basic labor exchange including initial assessment of job readiness; job match and job development; and job referral and placement. Also, Employment counseling for mandated target groups, i.e., veterans, the handicapped, and MSFWs is provided. (Employment information, e.g., labor market information, the availability of training programs, etc., is still shared with clients through IDES Applicant Retrieval System and the Computerized Job Order Retrieval System.)

Through Employ Illinois, a statewide employment initiative, IDES will provide computerized information on employment related activities performed by State agencies and IDES' for labor exchange and labor market information needs. IDES will give clients of other state agencies access to our systems, and help refer them to jobs.

The future: The demographic and employment trends outlined in Workforce 2000 indicate that employers will find it increasingly difficult to recruit qualified workers. As these trends become more apparent, the Job Service will be recognized as one of the lowest cost alternatives when employers look for ways to fill jobs in a tight labor market.

We in Illinois observe the following trends which are similar to the national predictions in our Project 1999 analysis:

- labor force expansion will depend on increased numbers of women, minorities and immigrants.

- white collar and service jobs will account for the bulk of employment growth; service industries will lead other industries in rate of growth

- jobs most difficult to fill will be at extremes of the skill range: very low skill (and low paying) and very high skill

- rapid technological changes will require frequent retraining or skill upgrading.

Employment Security Programs, with UI at the center, and Job Service and Labor Market Information on either side, will support these new workforce needs as demands increase.

ALTERNATIVE USES OF BENEFIT TRUST FUNDS

Currently, monies may be withdrawn from the Unemployment Trust Fund only for the payment of unemployment benefits. Should states be permitted/required to use these funds for alternatives to benefits such as training, employee bonuses, self-employment entrepreneurial projects, etc.?

States should be permitted but not required to use UI benefits to explore the feasibility of alternatives. IDES, in conjunction with the UpJohn Institute, has piloted a reemployment incentive program, funded by Wagner-Peyser 7(b) dollars. Pilot participants were randomly assigned to a control or one of two experimental groups. The latter were:

- Job Search Incentive Experiment (JSIE) group. Eligible claimants received a $500 bonus if they found employment of 30 hours a week or more before their eleventh week of benefits and stayed on the job for at least four months.

- Hiring Incentive Experiment (HIE) group. Employers received the $500 bonus if the JSIE hiring conditions were met. Claimants used the bonus as an employment incentive -- like a TJTC voucher.

The results of this incentive program were as follows:

- JSIEs' weeks of insured unemployment were reduced by an average of 1.15 weeks compared to the control group. Benefits paid over the full year were reduced by $158 per claimant. The average amount of state regular benefits paid during the benefits year to members of the JSIE experimental group was approximately a 6.4 percent reduction from the average amount paid to the members of the control group.

- Reduced benefit payments and weeks of insured unemployment for the HIE group were indicated following the initial claim, but no significant effect over the full benefit year was found. Also, employers of only 3 percent of the claimants in this group collected the bonus.

The American Economic Review in its September, 1987 article concerning this incentive experiment observed:

> "It is clear that the members of the experimental treatment groups experienced less unemployment than the randomly selected control group. Thus, we may unambiguously reject the hypothesis that the unemployment insurance benefit system is only a benign or nondistortionary income transfer. The results reported here are the first experimental demonstration of this proposition, and we believe them to be quite convincing."

IDES plans to follow up by examining the results of other models such as Washington State's pilot. In addition, IDES needs to determine the impact on the Trust Fund and degree of employer acceptance.

IDES recommends a conservative approach on the use of benefits for training and entrepreneurial projects and must examine the ramifications of this type of initiative in greater detail.

Some of the questions that must be answered are as follows:

- The impact on the Trust Fund. Many States which have implemented this type of program are using Trust Fund surpluses. The Illinois system is designed not to build up surpluses, but rather give employers the tax relief that will promote job creation.
- The reaction of employers to this use of the funds they have contributed.
- The sufficiency of the benefit amount to purchase training or, most especially, to start a business.
- The ability of claimants to support themselves and their families if benefits are used in this way.
- The criteria to choose candidates, standards to monitor progress of the venture, and a mechanism to recoup funds that are misused.
- The additional administrative costs of selecting candidates, reviewing their plans and monitoring their progress.
- The coordination with business development agencies or schools required to support such an initiative and the attendant costs.
- The efficacy of paying out 26 weeks of benefits up front, when many claimants return to work in less time.
- The potential for additional jobs creation.

ADMINISTRATIVE FINANCING ISSUES

Another issue which affects a State's management of its trust fund is the administrative financing of the employment security program. Each state is unique and should have more control over its administrative funds.

Currently, the Federal Unemployment Tax finances administration of State employment security programs, and States must meet certain minimum requirements to obtain these administrative grants. Should these Federal requirements be loosened and States given the responsibility of collecting their own administrative funds?

The current administrative financing structure causes serious problems for States. States find it very difficult to make sound business decisions on the administration of these programs when the Federal partner controls the amount and allocation of funding. Recapture and annual reallocation of funds frustrate states' attempts to manage their programs over the long term to minimize costs while increasing the value that these programs provide to their States.

States are currently responsible for funding all of the cost of paying regular unemployment insurance benefits in their States. This is 90 percent of the total cost of these programs. Federal decisions concerning the administrative funding of the program, which accounts for only 10 percent of the total cost, frequently results in poor decisions concerning the management of State UI trust funds. Benefits may not be paid as accurately and taxes may not be collected as efficiently, as a consequence.

Specific concerns are as follows:

- Chronic staff minutes per unit underfunding
- Chronic non-personal service underfunding of States like Illinois which have high fixed operating costs due to such factors as extensive EDP, rented office space, etc.
- The arbitrary and capricious manner in which funding is awarded for automation projects and new State law implementation.
- A UI funding formula that discourages and penalizes operating efficiencies.
- Beggaring the SESAs (and denying the public even better service) while a cash balance of over $1 billion exists in the system's dedicated operating fund.

Illinois believes that the only way to resolve these problems is to transfer the responsibility for the UI Trust Fund solvency and funding the administration of these programs to the States. States will then have both the flexibility they need and the incentive to make more business-like decisions concerning the administration of their programs.

Illinois urges further hearings on these vitally important issues. We also offer to provide more detailed information on Illinois law, programs or systems if so desired.

Mr. LEVIN. Thank you very much.
Mr. Menendez is next.

STATEMENT OF HUGO D. MENENDEZ, SECRETARY, FLORIDA DEPARTMENT OF LABOR AND EMPLOYMENT SECURITY, ACCOMPANIED BY THURMAN BURNETT, DIRECTOR OF UNEMPLOYMENT COMPENSATION

Mr. MENENDEZ. Thank you.
How are you, Mr. Levin?
Mr. LEVIN. Fine. Welcome to Capitol Hill.
Mr. MENENDEZ. Thank you very much.

I am Hugo de Menendez, Secretary of Labor for the State of Florida. And next to me is Mr. Thurman Burnett, who is the director of unemployment compensation.

First, I would like to thank the chairman and members of the subcommittee for allowing me to appear here today. The purpose of my testimony is to point out some of the problems with H.R. 2676 in its present form and to comment on the financing of the unemployment compensation program in general. I would like to commend Congressman Don Pease and all of the others who worked so hard to put H.R. 2676 together.

The State of Florida is very fortunate to have a healthy unemployment compensation trust fund. As of December 1 of 1987, the fund balance is approximately $1.7 billion, which is the third-largest in the Nation. This is enough money to pay benefits for 62 months, even if we do not collect any more money. We believe our fund will withstand any recession that we might experience.

I would like to state emphatically that I am against any bill that would unnecessarily increase spending at the State or Federal levels. It is obvious that H.R. 2676 in its present form would significantly increase Federal spending to some extent and State spending also. This would seem to fly squarely in the face of Gramm-Rudman-Hollings and the commitment to reduce expenditures. It appears likely that Congress will extend the two-tenths percent FUTA tax on the basis that it would help reduce the national debt. If H.R. 2676 is passed, it will likely use the two-tenths percent FUTA tax, and there will probably be a need for a further increase.

One very objectionable feature of H.R. 2676 is the alternative extended benefit trigger using the total unemployment rate. We object to using the TUR because the figures are not accurate, as the insured unemployment rate is. The TUR is more subject to fluctuation, and it includes people for whom unemployment compensation was never intended. The Interstate Conference of Employment Security Agencies—ICESA—considered using the TUR in connection with previous extended benefit bills and concluded that it was not desirable.

We do not believe it is feasible to pay extended unemployment compensation to sub-State areas. The labor force in this country is extremely mobile, and I do not believe that you can isolate workers to defined areas. It is not uncommon for individuals to live in one area and work in another. And they frequently do move around. It would be very difficult to administer an unemployment compensa-

tion program on an area basis. Reports and records which would be required to be kept on such a project would be enormous.

Generally speaking, we are opposed to alternative use of unemployment insurance trust funds. Once you open the doors, it stands to reason that there will be more and more demand made for this money. When trust funds are used for different purposes, States will face financial problems. And again, additional funds will have to be appropriated. I am not opposed to States experimenting on a limited bases on such things as training programs as long as it is on a voluntary basis. However, I really don't see the need for additional legislation allowing individuals who are in training to receive unemployment compensation. The State of Florida—and it is my understanding all other States—have such provisions as a Federal requirement.

The practice of paying individuals who contend that they are going into self-employment may be successful in some European countries, but I think we should approach it very cautiously in this country. There are inherent problems in paying individual lump sums, and the potential for fraud is very real. While this concept is initially attractive, it does not seem that workers who face long-term unemployment because of slow business conditions will be likely to succeed as entrepreneurs under the same adverse conditions that laid them off.

In summary, we cannot support H.R. 2676 in its present form. We strongly oppose using the TUR in calculating extended benefit periods. We would prefer to see the sections relating to demonstration projects also deleted from H.R. 2676. Regarding H.R. 3213, as a minimum we think that the demonstration projects should be very limited, and the language of the bill should be more restrictive. Demonstration projects are frequently the prelude to mandatory participation.

Before I conclude my remarks, I want to bring to this committee's attention a very serious problem which confronts the State of Florida. It is in regard to the FUTA tax and grants which are returned to the States from the tax to administer the employment security program. Florida receives only 56 percent of the FUTA tax set aside for State administrative expenses. Compare this with the 135 percent which Michigan receives, the 219 which North Dakota receives, and the 352 percent that Alaska receives. Over one-half of the States are winners, since they receive in excess of 100 percent of their share of administrative funds. Twenty-one States are losers, since they receive less than 100 percent. Most of the Southern States are losers. A more dramatic imbalance occurs in the distribution of extended benefits. Over the last 10 years, Florida claimants received only 3.6 percent of the FUTA funds paid by Florida employers and set aside in the extended unemployment compensation account.

While the number of employers served by the unemployment compensation has increased, administrative funding has not. Therefore, the agency is forced to process a greater workload with the same amount of dollars and no funds to replace archaic, obsolete equipment and facilities. As everyone knows, the State is growing rapidly and we should be extending our services. However, due

to inadequate funding we are closing offices, resulting in loss and delay of services to clients.

This inequitable distribution of funds has reached a point that it requires action on the part of Congress. The Appropriations Act should specify that States should receive a minimum of 80 percent of their FUTA tax contribution. While I recognize that H.R. 2676 and H.R. 3213 do not directly affect appropriations, I urge this committee to give close scrutiny to the current inequities among States and consider adjustments or improvements to correct this imbalance. I intend to use every opportunity to rectify this unfair distribution of FUTA funds.

Florida is growing at the rate of 900 residents per day. Each dollar of FUTA tax which is withheld from Florida is a dollar that employers cannot use for investment, reinvestment, or expansion. Florida needs to have its share of FUTA tax so that in a sound way it can cope financially with problems that the vast number of new Floridians are creating for us.

I thank you very much for this opportunity.

Mr. PEASE [presiding]. Thank you, Mr. Menendez.

Mr. Levin?

Mr. LEVIN. Thanks.

Just a couple of quick questions—and I'm sorry I missed the testimony of some of you.

First, if we had next year a recession like we did in '82, would the benefits system, in your judgment, be adequate as it is now structured?

I understand the technical objections, and I have heard the testimony of some of you and did look at the written statement of the others.

But is the system that we now have adequate to meet a recession like we had in 1982–1983? Does anybody here think it is?

Mr. MENENDEZ. I think it is. In Florida it is.

Mr. LEVIN. Is it?

Mr. MENENDEZ. Yes.

Ms. WARD. In Illinois it is.

Mr. LEVIN. In 1982–1983, for those who were unemployed for a lengthy period of time, what happened? Did Illinois trigger on to extended benefits? What went on in Illinois?

Ms. WARD. Yes, we had extended benefits during that period.

Mr. LEVIN. For how long?

Ms. WARD. Over a year—18 months, approximately.

Mr. LEVIN. And then what happened?

Ms. WARD. They triggered off early, approximately at the end of 1983.

Mr. LEVIN. And what happened to the people who were still laid off?

Ms. WARD. In terms of their benefit eligibility?

Mr. LEVIN. Yes.

Ms. WARD. They exhausted that at that point in time.

Mr. LEVIN. What happened to them? What was the unemployment rate in Illinois at the end of 1983?

Ms. WARD. In 1983 it was about 12 percent.

Mr. LEVIN. And so what happened to those people?

I don't mean each. You know the thrust of my question.

You're defending—you are saying the status quo is adequate.

In 1983—and I did not bring all of the figures, but I remember them too vividly—we were wrestling with the problem of thousands of people who had exhausted their benefits.

Ms. WARD. That is correct.

Mr. LEVIN. So how can the system be adequate if thousands were left without any protection whatsoever?

Ms. WARD. Well, I think that you may be misinterpreting what I said.

I said that we support the current system but that we were eager to look at combinations of EB and FSC.

Mr. LEVIN. So the system isn't adequate. I mean, we need some changes in the system to prepare for the day—and hopefully there will never be, but we know there tend to be cycles—of a period with the same intensity of unemployment as 1982 and 1983.

Ms. WARD. Clearly, a period of that intensity is disruptive no matter what kind of program we have in place.

Mr. LEVIN. But let me just—if I might interject.

True. But whatever we have in place—but what we have in place isn't adequate.

Ms. WARD. If you're looking at the EB law alone, you're absolutely right. It is not adequate. The existing EB law alone is not adequate.

If that's your question, I agree.

Mr. LEVIN. So when you said you thought the system was adequate—I'm not quite sure what you meant.

Ms. WARD. I didn't say that.

I said that we support the current EB law. We think that it does address very positive needs.

We are not suggesting that it be eliminated in any way but that there are other issues that need to be addressed in addition to the current law. Combining it with a Federal-supplemental type program is one issue that would be interesting.

We are concerned about the financing of such a system. We think that's a very significant issue that has to be examined, and we would be interested in exploring that.

In addition, the issue of training—government-supported training—has been put on the table since 1982.

There is a great deal more support for these individuals than there was in 1982, so we can't look at 1982 EB in isolation from the other multitude of programs that are currently being financed.

JTPA title III dislocated workers to begin with. The Trade Act, which is meant specifically to deal with one significant component of these workers and the coordination of all of those benefit programs to deal with long-term structurally unemployed, is a very important issue to be examined.

Mr. LEVIN. Anybody else want to comment?

Ms. KILBANE. Yes. On behalf of the Interstate Conference of Employment Security Agencies, our experience during the 1982–83 period when FSC, in fact, replaced EB in many States, clearly illustrates that EB was not sufficient for that period and ICESA would support some changes to the program.

And, wearing my other hat, Ohio also concurs in that.

Mr. MENENDEZ. Congressman, I'm not too sure that there aren't programs already in the Federal Government that don't address some of these issues.

And I think the question is whether we're going to make this program, by extending it 30 more weeks—meaning a period of 56 weeks—if it's going to become a partial welfare program.

I think that maybe Congress should be thinking in terms of tax credits to employers so that they will put these people back to work. There are some types of tax credits, again, for training, combining the job services, as we do in Florida.

As soon as someone comes in for unemployment compensation, they tie in with the job service. We test them. We try to find them a job. We try to provide them training programs.

I think that's the answer—it's to get people to work, and I'm sure that's what the interest of Congress and each of you gentlemen here is—that is your interest so that people do not have to suffer the indignity of being without work and being able to support their family.

The question is that there are programs available, and there are going to be. Right now there are—and there are going to be more in the future—many jobs available.

The problem is that the people aren't qualified or trained to occupy the jobs that do exist in these new industries.

And it's very nice for a person to be waiting around for candles to come back and say, "I'm a wick maker, and I'm waiting for the wicks to come back. And I don't want training."

I think that we have to say to an individual, "If you want a check—an unemployment check—you're going to have to accept training, because we can tell that that industry is no longer coming back." Or, "That industry, for whatever the reason, is not going to survive. Therefore, here—we will provide you training to occupy these jobs that are developing and no one can occupy because of the lack of training."

I mean, there are enough jobs there if we can train the people. I agree with you—it's training.

I don't know that this is the system. There are JTPA programs, there are enterprise zones that can be utilized, there are tax credits that can be utilized.

I think that you give the private sector an opportunity and the private sector will have the answer.

Ms. BURNS. Everyone else has commented, so Massachusetts will too.

I think that there are two parts to it.

One is the preventive medicine that we could take advantage of during periods where the unemployment trust fund does have more money in it than a solvency standard would suggest is reasonable. We should be able to take those dollars to provide training to people who need it in order to go from being a wigitmaker to being something that is still fruitful.

I think the second part is that there is always the issue of the bridge. It has always seemed unusual to me that we expect that people will find work when the economy goes bust and EB and FSC are triggering.

When there are no jobs, it's very hard to find a job. And therefore, we do need to figure out a way to be able to do more for those people.

We are clearly in the position right now in Massachusetts to try and focus on the preventive medicine and to try and make sure that more of that happens in the future. And I think that's different in other States.

Mr. HEARTWELL. Mr. Levin, I think one issue of it that has been touched upon but hasn't been thoroughly articulated is the calculated diminution of Employment Service by this administration.

When you look back when the Employment Service was fully funded and respected and recognized as a labor exchange, we were actually involved with 23 percent of the labor force. And now at its lowest ebb, we are down to 6 to 10 percent.

Mr. LEVIN. Down to?

Mr. HEARTWELL. Six to ten percent.

Now, the point I would like to make, sir, is that I think we have studies from the past—and I can go back to the 1974 recession, which came practically with no warning.

And I think one thing that it proved was that the system was resilient, because Congress did pass the FSC, EB, and everything in December. And by January the 15th, the States had it in place.

But my point is every study that has been made, including one by CBO, one by Stanford Research Institute and others, show that the sooner you can place an unemployment recipient back to work, of course it has a tremendous effect on the economy.

Now, if the Employment Service had the funding that it had when it was recognized as a true labor exchange—and you can send a document of the services that it made to UI claimants. I think this is one thing that has been overlooked—is that the Employment Service, although we have some demonstration projects and we have some innovative projects that are being tried by several of the States.

When you look at the employment security administrative account that's in the unified budget—the trust fund—and recognize that you have this rather large surplus. And we are certainly sensitive to the budget deficit reduction that the Congress is going to approve now and has been approving—we recognize this. But we also recognize that this surplus is really just a figure that should not be in the unified budget.

But being practical about it, there are unobligated expenditures in that employment security administrative account which under law should come to the States for the administration of their programs.

And our point is if the Employment Service could be actually funded at the levels of what it was funded when it was providing these services, which would be—we have been reduced from about $950 million down to $700 million in this administration—that this would be, as I think several of our members and our member States have testified—you need the linkage, you need the help of a Job Service.

But we have had so many other programs thrust upon us, along with this reduction in funding, that the service that should go to

you, our claimants, and some of the innovative services the States would like to try, simply we just do not have the funds to do it, sir.

Mr. LEVIN. I think several of you have given the best testimony on behalf of the bill that Mr. Pease introduced—or the thrust of it—that there needs to be some important steps taken toward turning our unemployment comp system much more toward a revitalization system in terms of the individual employee's opportunity to work.

I agree with what you said, Mr. Menendez. I don't think that's the reality today on unemployment comp lines in most parts of this country.

And I don't mean this critically. I think the system is still much more tuned toward income maintenance, and there I think it's inadequate—certainly for a recession.

I didn't mean to challenge—I didn't mean to paint you as a defender of the status quo exactly. But it sounded to me like you were saying our system is ready for another recession.

I remember walking up and down the unemployment comp lines in Michigan in 1982, and I don't think it was ready, in terms of income maintenance of people who had been very much in the work flow and who were thrown out on their duffs—period.

I also don't think that we have made very many major strides toward turning it so that in addition to adequacy as an income support system it's imaginative and effective comprehensively as a dislocation response mechanism.

I would appreciate if each of the States represented here—we have some of the materials—might send us some information—for example, the level of your Employment Service today—to pick up the point just made.

Is your Employment Service today larger or smaller than it was ten years ago?

Mr. MENENDEZ. It's smaller.

Mr. LEVIN. Smaller.

Mr. MENENDEZ. But I think we are doing a better job.

Mr. LEVIN. It's smaller, but you're doing a better job.

Mr. MENENDEZ. Yes. I think that the way we are working and coordinating with some of the other programs—I think that we are becoming more effective. Large alone doesn't make better.

Mr. LEVIN. I agree with that. Small isn't necessarily better either.

Mr. MENENDEZ. No, no, of course not.

But I think that when you work in unity with so many of the other programs and you co-locate to make it easier—for example, some of our training people work with the Job Service when they are talking to each other and they're referring one to the other. I think that we're becoming much more effective.

We're trying now—at least now in my administration—to accept labor in a prominent training division, which I also head. It's now working with and talking to the Employment Service and the Job Service, and both of these are talking to unemployment compensation.

And I'm trying to co-locate them wherever I can so when an individual comes looking for his unemployment, we can say, "Look, we've got jobs that are available. Why don't you go over there and

let's give you this aptitude test or this dexterity test. Let's see what we can find."

Mr. LEVIN. Do you have all the resources you need to carry that program?

Mr. MENENDEZ. Well, we're doing the best we can with what we've got.

Yes—what we don't have—we can always use more, but we're doing quite a good job, considering.

Mr. LEVIN. If you could send to the committee some specific information on how you're intertwining.

Mr. MENENDEZ. Sure. Be glad to.

[The following was subsequently received:]

Florida Department of Labor and Employment Security
Office of the Secretary

Bob Martinez
Governor
Hugo D. Menendez
Secretary

March 8, 1988

The Honorable Sander Levin
Member of Congress
323 Cannon House Office Building
Washington, DC 20515

Dear Representative Levin:

I want to thank you again for the courtesy shown me when I testified before the Public Assistance and Unemployment Compensation Subcommittee on December 14, 1987.

In the course of the hearing, you asked whether the Employment Security system is larger or smaller than ten years ago and whether any change has been beneficial. My response was that the system is obviously smaller, but a smaller system is not necessarily bad. When unemployment levels drop and there are fewer people claiming Unemployment Compensation benefits or needing assistance in finding work, staffing for the system can obviously be reduced. The staffing and funding allocation formulas administered by the U.S. Department of Labor (USDOL) automatically mandate such adjustments. Staffing and funding cuts also impel greater internal efficiencies, such as organizational streamlining, increased use of automation, cross-training and other innovations which help to maintain quality and service to be maintained in the face of reduced resources.

The problem arises when the cuts outstrip the ability of even creative administrators to devise new ways of maintaining quality and service. At that point the system has been trimmed below the "bare bones" level, causing short-term and long-term structural damage. The impact is manifested by an agency's inability to achieve federally mandated performance standards even at times of low work load. As I indicated at the hearing, Florida is still managing to meet those promptness and quality standards with increasing difficulty. Using a military analogy, it is common sense to reduce the size of an army during peacetime. However, if insufficient funds are provided to allow for minimal garrison status or any standards of readiness, that army is likely to be obliterated in its first wartime battle.

You also asked how Florida is intertwining Unemployment Compensation and Job Service resources, and where we are experiencing shortfalls. In addition to the internal efficiencies, Florida benefits from a close working relationship between Unemployment Compensation and Job Service staffs. To the maximum extent possible, the offices of the two programs are colocated. The staffs are able to help one another, as well as making their services more conveniently accessible to the public. Florida's law imposes strong availability and work search requirements on Unemployment Compensation claimants. Because claimants are required to register, the Job Service performs an essential role in monitoring and assisting the work search efforts of Unemployment Compensation claimants. Complete interchange of staff is inhibited by strict federal limitations on having staff paid from one particular program fund perform any services outside that program. The technical complexities of the different programs also make it virtually impossible for staff workers to offer expert service in all areas.

The one area of particular shortfall experienced in Florida is Nonpersonal Services (NPS) funding. Apparently the USDOL formula to determine NPS allocations was established several years ago when the cost of living in Florida was among the lowest in the nation. Unfortunately, it appears that the formula has not changed as Florida has grown rapidly in terms of population, business activity, work load and cost of living. Of the fifty, Florida now ranks in the top five states for having the highest cost of living, yet its NPS allocation ranks among the lowest. As a result, Florida has had to make up the shortfall by leaving positions vacant or otherwise reducing services.

The persistent shortfall in NPS funding exemplifies the more fundamental problem. The financial difficulties for the states can be caused either by Congressional appropriations action or application of USDOL allocation formulas. Even where Congress provides adequate funds to operate a sound program on a nationwide basis, particular states can still find themselves below the "bare bones" level after allocation of those funds by USDOL. Most of the formulas devised by USDOL seem to have a plausible basis, particularly if scrutinized individually. Logically, it would seem that the cumulative effect of these formulas would be to provide an equitable distribution of administrative funds over the long haul.

Using the statistics provided by USDOL, the Florida Employment Security Program has received back only 56% of the FUTA taxes

which were paid by Florida employers for state administrative expenses. That percentage is not just a fluke that occurred in a single year but is an average of Florida's return since 1975. During that period, Florida has continued to experience remarkable growth and corresponding increases in operational costs, without a corresponding increase in federal funding allocations.

While we recognize that regional economic problems may require that extra funds be devoted to particular states or areas for a limited period of time, it is unconscionable that Florida and certain other states should be subjected to chronic underfunding indefinitely. For that reason, I have proposed that you seriously consider specifying that states should receive a minimum of 80% of their FUTA tax contributions which are available for administration of the state programs.

Your knowledge and great concern about the Employment Security Program is greatly appreciated. Your interest is also very timely; our best opportunity for identifying and correcting any problems with the system is now when work load is relatively stable. I thank you for this opportunity of offering my thoughts on these issues of great mutual concern. Please let me know if there is any further information or assistance which I or my staff can provide.

Sincerely,

Hugo D. Menendez
Secretary

HDM/usb

cc: The Honorable Thomas J. Downey

Mr. LEVIN. And also what resources are being allocated, the extent of this program, and what resources you are short of. Give us details as to the number of personnel doing it.

We may walk some of these lines some day and ask people to see what it is from their vantage point.

Mr. MENENDEZ. I previously have been in Federal service and have worked with many of the different committees in other programs in other areas where I used to be involved in. And I know that all of the committees have very active and qualified staffs.

So at any point in time I would welcome your staff to come to Florida, and I will show them all the courtesies and whatever we can do to try to show them what we are doing. I'd welcome you.

I can't pay for your trip, but we'll help you out.

Mr. LEVIN. Thank you, sir.

Mr. PEASE. Thank you, Mr. Levin.

Could I ask for a comment from the panel. Don't all of you feel you have to comment on each one, but if you have any opinions, I would like to have them.

One of our bills proposes using the total unemployment rate as an alternative trigger to the IUR. In other words, it could be either one. IUR might be four percent, and a comparable TUR would be 9 percent or 10 percent—whatever.

In general, is it a good idea to use TUR as a possible alternative or not?

We'll start with you, Ms. Kilbane.

Ms. KILBANE. Mr. Pease.

In the ICESA testimony that we submitted, we question whether it would be—whether we can use TUR because of its erratic nature. It jumps around a lot from month to month because it is based on a very small sample, as you know.

And so in addition to questioning its reliability, would be able to use it? What about these big fluctuations, which—in Ohio we have had huge jumps 1 month, and then it will go back up and stabilize. And what would that do for the administration?

It's tempting because there are times when total unemployment has in fact been high and our insured unemployment has been very low. And so I think that the goal is something worth pursuing, but according to both our technicians in Ohio and ICESA, there are serious concerns about using TUR as it is currently calculated as an alternative method.

Ms. WARD. I worked with the UI Committee in ICESA a couple of years ago while we were examining these relationships between the IUR and the TUR.

I think everyone feels a degree of frustration that we have not been able to adequately measure what it is that we want to measure.

I do not believe that the TUR—for the same reasons that Grace has stated—is an acceptable replacement.

Mr. BURNETT. In Florida we would oppose the TUR.

We have a very wide divergence—right now, one of the country's most widest.

And there are reasons for that. There are people—we have new people, and we have old people coming to Florida.

We have a lot of students that have never worked for which this program was never intended. If it's passed, they still won't benefit.

We have older workers who have been out of the labor force for 3 or 4 years and decide to come back marginally. And it still won't cover those even if we have the program.

So the TUR is not a true indication of people really seeking employment in our State.

Mr. PEASE. Ms. Burns, do you have any comment?

Ms. BURNS. I would agree with Sally and Grace.

Mr. PEASE. I understand the problem.

One of the reasons for this hearing is to try to identify practical problems and figure out ways around them.

What we're after, of course, and what we're concerned about and what motivates this section is the fact that in 1982, 1983, 1984 we had some States triggering off of IUR and off of EB which had unemployment rates of ten or eleven percent—total unemployment rate.

And in those States, as new people became unemployed for the first time, they were operating trying to find jobs in an atmosphere where there weren't very many jobs around. And yet they did not qualify for EB at all.

Do you have any alternative suggestions for dealing with that problem?

[No response.]

Mr. PEASE. Silence is golden. We're looking at you all for leadership.

Well, let me try out an idea on you.

It seems to me that some of the concerns that you have raised might be addressed if we were to use a rolling average of TUR. Say, over a 6-month period each month you add in the newest monthly TUR rate and drop off the one that's 6 months old so that you even out those peaks and valleys in the TUR.

And also—you have brought up a good point this morning—I think we would want to say that once you trigger on to EB as a result of TUR, you could not trigger back off the next month or the next month after that but you would be guaranteed to stay on for any period of time—6 months or whatever—so that you weren't on and off all the time.

Does that sound like it might address some of your concerns?

Ms. KILBANE. Mr. Pease, yes.

I think that the goal again is one worth pursuing. And certainly if you use some kind of a rolling average or an average that stabilizes the month-to-month fluctuations, that that does address that concern.

Mr. PEASE. Let me turn next to one of the basic elements of our bill. And that is that it's desirable to combine EB and FSC so that the States don't have to implement the FSC on a moment's notice, that there is some predictability to it, and that the benefits go up and the State match goes down as overall unemployment gets higher and higher.

What do you think of that basic premise of the bill? Does that hold water or not?

Ms. KILBANE. Mr. Pease, I would say that ICESA and the State of Ohio both would support that concept.

I think that it's important to do it now, and I commend this subcommittee for looking at it.

As State managers who are trying to implement these programs—sometimes retroactively, let alone at a moment's notice—it makes sense that we know what we're looking for, that we combine them now, that we have it in place so that we're able to know what we need to do when a certain trigger point—whether it's TUR or IUR—is hit. And you can train your staff and be prepared to implement it in a logical and good management way.

So we would certainly support both combining them and doing it now.

Mr. PEASE. Anybody else have a contrary view?

Ms. BURNS. No, in Massachusetts we agree with Grace.

Ms. WARD. I also would add that there have been several proposals to tie those benefits to some kind of a training program at some point in time.

And I think that's included in your bill. I don't think that was mentioned, but I think that is a feature that is extremely attractive.

Mr. PEASE. Good. I am delighted to hear you say that.

What about sub-State triggers? This bill does not mandate sub-State triggers. It tries to encourage demonstration projects to see whether it's feasible or not.

What do you think? Do you think that if you're in Minnesota and you're on the Iron Range and you've got 25 percent unemployment that you ought to be denied EB because things are going great in the Twin Cities and that sort of thing?

Ms. BURNS. We went through something like that in Massachusetts because there were some State senators and representatives that were very interested in that.

One of the problems that we ended up getting into was trying to measure it. That was obviously something that you would like to explore.

The second thing was where does somebody live versus where do they work? And how do you tell someone who lives next door to someone else that they are not eligible just because they don't work in the same commuting distance?

It's certainly in terms of the philosophy that we would like to help people who are in a situation where they really do need the help. We would support that.

But there are problems—we went through a long period of trying to figure out a way to do it, and it would be very difficult.

Mr. PEASE. Anybody have any different view on that?

[No response.]

Mr. PEASE. Before we leave this, one of the arguments you have heard me making this morning for acting now while unemployment is still relatively stable is that if we were to make a substantial change in the UI laws, States need some implementing time.

I have been quoting a year or 18 months. How much time, ideally, should you really have?

Ms. BURNS. From our perspective, I think we always want as much as we can get.

But I also think that it's unrealistic to expect that as bureaucrats we aren't going to be continuously asked to make changes as fast as possible and to do it retroactively.

We've spent a lot of time trying to teach our staff to be responsive, to be able to be flexible. And I think that means that whenever you can do it, we will put it into place.

But the more time, the better.

Mr. MENENDEZ. My director says we need at least 18 months.

Mr. PEASE. Eighteen months?

Ms. KILBANE. Ohio could do it in a year, but I know that there are some States that would have problems with that, as evidenced on the old FSC.

Mr. HEARTWELL. Some States don't address legislative issues.

Mr. PEASE. What about the solvency issue? Would you agree with the GAO that a lot of States are skating on thin ice in terms of their reserves if we were to have a fairly major recession?

And if you agree, what do you think Congress ought to do about it?

There has been some suggestion that we ought to set some standards and force the States to meet them and some other suggestions that we ought to raise the FUTA rate. I suppose that opinion would have to vary from State to State, depending on what your reserves were. I guess one other suggestion was that we give you a higher interest rate on your deposits with the trust fund if you're solvent.

Ms. WARD. In my testimony I commented on that issue, because I think that there are other issues besides the level of reserves that are important to look at when you look at whether or not a State will be able to weather a recession with its fund.

You weren't in here for my testimony, so I'm going to repeat a part of it because I think it's an important perspective for you to have.

Illinois just recently signed into law a new UI tax system that has some innovative features. We researched the needs of our State for 5 years and did actuarial studies and created various computer simulations to test different types of recessionary problems, including back-to-back recessions with this new model.

One of the goals was to minimize the total amount of reserves required. While we have a permanent fund-building component, we're starting out, after having paid off our debt, with about $300 million to start fund building after more than 12 years of debtor status.

We are still concerned about taking multiple billions of dollars out of the economy to maintain some standard of reserves. Instead, we have included features in our bill that will allow us to increase and freeze or decrease benefits according to the economic conditions in the State and the adequacy of the fund.

Similarly, actual rates will increase and decrease automatically. There is an indexing feature on both sides of the fund inflow and cash outflow.

And we have also added a surcharge that would be implemented retroactively mid-year, should conditions get so bad that we would be facing borrowing from the Federal Government in lieu of the FUTA penalties.

With those features and a new State experience factor that allows us to measure on a year-to-year basis actual cash inflows and outflows from the fund and in the following year to charge all employers an increment to pick up that unfunded liability, we have been able to demonstrate that our fund will be solvent. It does not have large reserves nor will it ever have what would normally be expected as an acceptable standard of reserves.

So I think we have to look at things besides adequacy of funds to examine the issue of solvency under various recessionary conditions.

Mr. PEASE. Very good. I'm delighted to have you repeat that.

So you're following the unemployment system equivalent of the just-in-time delivery to automobile factories. You want to get the funds there when you need them but not keep them around in inventory when you don't need them.

Ms. WARD. I guess that's close to the assessment.

Mr. PEASE. I come from an auto-making district, and I try to use that analogy whenever I can.

Did you want to say something?

Ms. KILBANE. Yes, Mr. Pease.

I think that when you ask what can we do about encouraging a more solvent fund, I would just ask that whatever Congress would deem to encourage would certainly be a positive encourage and not a punitive measure, which has happened to States in the past.

In Ohio, for example, as soon as you get into a depression or recession situation which was not anticipated which was deeper and longer than any ever experienced in the State before, you start getting dinged by the Federal Government in terms of interest rates mounting and your FUTA penalty rising so that you end up with a double-whammy kind of situation—that you're not only spending all of the money you've got and trying to find jobs for people, but you're also getting penalized.

I think that if we truly have an unemployment insurance system—insurance meaning that we share the risk a little bit among the States—that such severe penalties should not be imposed on the States.

So I would just encourage that—I mean, if it's increasing interest rates on earnings or something—that it be positive rather than punitive.

Mr. PEASE. Two other quick things, and then I'd like to move on.

My impression from my own State is that the combined unemployment compensation payments system/employment service system has been tilted in the last few years in favor of handing out money to people who are unemployed rather than trying to find job openings and jobs for people who are unemployed.

Is that an incorrect impression?

Mr. HEARTWELL. No, sir.

I think all of the States would agree with that statement.

And I think when you look, as I was indicating earlier to Mr. Levin, the programs that have been layered on the Employment Service without commensurate funding or even support such as the welfare incentive, the targeted jobs tax credit, TAA, and now we're looking at immigration.

The Job Service has been actually, by osmosis almost, taken out of its major role of supplying assistance to unemployment insurance recipients. And I think we have a fractured system as a result of that.

And again, I would emphasize with the additional reserves in the unified budget that are not designated—we understand the circuitous route that they have to go through. The Employment Service doesn't need $2.1 billion or whatever the top figure would be, but just to get it back in a stable condition to provide these services and to work with unemployment insurance is—I think is essential, sir.

Mr. PEASE. Thank you.

Ms. BURNS. From the Massachusetts perspective, I would say that we've been fortunate enough to replace some of our lost Federal revenues with some State revenues.

And the difference in the way that we have been able to focus our attentions has been dramatic. We have established real opportunity job centers where we really are placing people. We have a goal to place people at $6 an hour and not below.

So we are trying to move people into the work force for good. And it works very effectively.

And interestingly enough, the unemployment insurance claims takers have their own job placement goals. They have to move people from one side to the other. And it works.

So I would argue that if you can find the funding, it certainly is worth it.

Mr. PEASE. Terrific.

Then finally, I want to join Mr. Menendez in expressing concern about the imbalance in the distribution of administrative funds for the unemployment system.

I think Ohio doesn't do as badly as Florida, but we don't do as well as we'd like to do.

You've got a national association. You've got half winners and half losers in your association.

Is your association addressing this situation, and do you have any recommendations for Congress?

Ms. KILBANE. Yes, Mr. Pease.

The Unemployment Insurance Committee of ICESA is addressing this issue. It worked all year in terms of developing some general goals or specific goals which were adopted by the membership. And we'll spend this year in trying to get a formula which States can agree on.

Obviously, since it is 50/50 winners and losers, we need to compromise. We need to bring together some creative ideas, which there have been.

In addition, there are other States who are pursuing other kinds of recommendations.

But I would say ICESA will be coming forward this year with a recommendation.

Mr. MENENDEZ. I think there are more winners than losers, so the losers like Florida have a rough time.

I think there are only 21 losers—and 21 from 50 is what?

Mr. PEASE. We'll have to see if we can't correlate the loser States with the membership of this subcommittee. That might help.

Well, let me thank you all for your testimony.

I'm sorry I wasn't here. I'm trying to get some highway construction money, but that's another problem. I had to step out for a few minutes.

But I have appreciated the dialogue a great deal. You are the people who run the program. We look to you for our expert knowledge, and we hope we can continue to do so in the future.

Our next panel will be made up of some academic experts: Gary Burtless, senior fellow, the Brookings Institution; Wayne Vroman, senior economist, the Urban Institute; Walter Nicholson, professor of economics, Amherst College; Marc Bendick, economist, Bendick & Egan Economic Consultants; and R. Douglas Rivers, associate professor of political science, University of California at Los Angeles.

Welcome, gentlemen. We're pleased to have you here.

And I think we'll start right off with Mr. Burtless.

STATEMENT OF GARY T. BURTLESS, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. BURTLESS. Thank you.

We have an incentive to be brief, and that is we're hungry.

I have prepared a longer formal statement on the questions being discussed by the panel, but I only wish to make a very brief comment now.

Mr. PEASE. If I could interrupt, let me just emphasize for everybody, as I think Mr. Downey did before, all of your statements will be put in the record, so if you want to summarize, that's fine.

Mr. BURTLESS. Over the past 3 years the labor market has shown a remarkable resilience in recovering from its worst postwar recession. But the Nation's unemployment insurance system has emerged from the recent business cycle tattered and somewhat worse for wear.

This trend carries worrisome implications for the future. We should patch up some of the worst trouble spots in the system before they come back to haunt us in the next recession.

Unemployment insurance serves two essential functions, only one of which has received very much emphasis so far this morning. It protects workers from severe income and consumption losses when they are laid off from a job, and it provides the economy with much-needed consumption boost when it falls into a recession.

Unemployment insurance is one of the nation's most important automatic stabilizers. Trends over the past 7 years have eroded the value of unemployment insurance both as an income protection program and as an automatic stabilization policy. Three trends deserve special emphasis.

First of all, about 25 percent fewer unemployed workers are collecting benefits than we should expect based on long historical experience with the program. This trend began some time in 1980, and it continued through 1984.

Although the fraction of job losers collecting benefits has rebounded a bit from its lowest level in the third quarter of 1984, it remains one quarter below the fraction that prevailed in the 1960's and 1970's.

Second, as a result of the drop in the fraction of job losers who collect unemployment benefits, there has been a corresponding drop in the insured unemployment rate relative to the civilian unemployment rate. The IUR no longer serves as a reliable or credible indicator of conditions in the job market, yet it continues to be used to trigger extended unemployment programs when the economy falls into recession.

The deteriorating performance of the IUR means that State extended benefit programs are no longer turned on in a timely fashion. As a result, these programs no longer serve their essential insurance and stabilization functions during recessions.

Finally, our Nation has gradually transformed unemployment compensation from a tax-exempt to a fully taxed form of income. While I favor this reform, I think many of its proponents forgot that the taxation of benefits makes them 15 to 20 percent less valuable than they used to be in 1978 and earlier.

Income protection from unemployment insurance has been cut, and the automatic stabilization function of the program has been impaired. The combined effect of these trends can be stated fairly simply: Unemployment insurance now provides about 40 percent less income protection and countercyclical stimulus than it did during the 1960's and 1970's.

Let me repeat that: Unemployment insurance now provides about 40 percent less countercyclical stimulus than it did throughout the 1960's and 1970's.

At a minimum, Congress should reverse one of these trends by reforming the extended benefits program. The trigger mechanism should be revised so that it is based on a more accurate measure of current labor market conditions.

I suggest that the committee consider using information from the monthly current population survey as well as the unemployment insurance system in devising a new trigger for the EB program

Whatever new trigger mechanism is used, Congress should turn its attention to this problem before the next recession occurs instead of in the midst of that recession.

The unemployment insurance system badly needs improvement if its economic usefulness is to be restored, both as an insurance program and as a provider of countercyclical stimulus.

Thank you.

[The statement of Mr. Burtless follows:]

86-407 - 88 - 5

THE ADEQUACY AND COUNTER-CYCLICAL EFFECTIVENESS OF THE UNEMPLOYMENT INSURANCE SYSTEM

Testimony for the
Committee on Ways and Means

December 15, 1987

by

Gary Burtless[1]

Overview

The unemployment insurance system is an essential pillar of the U.S. safety net and provides an important source of counter-cyclical stimulus when the economy falls into recession. Legislative and administrative changes in recent years have reduced the adequacy of unemployment benefits and diminished the effectiveness of the program as an automatic stabilizer. Congress and the President should adopt at least one simple reform in the system in order to provide additional protection to jobless workers and restore the ability of unemployment insurance to stimulate the economy during recessions.

The Decline in Unemployment Insurance Coverage

During the 1980s unemployment rose to new post-war highs, but the share of unemployed workers drawing unemployment benefits fell to new lows. Figure 1 shows the average percentage of all unemployed workers who were covered by some form of unemployment benefits over the period 1973 through the third quarter of 1987.[2] Since 1983 this percentage has fallen substantially in comparison to the levels prevailing in the 1970s.

The proportion of unemployed workers collecting benefits has shrunk for several reasons. First and most important, fewer unemployed workers

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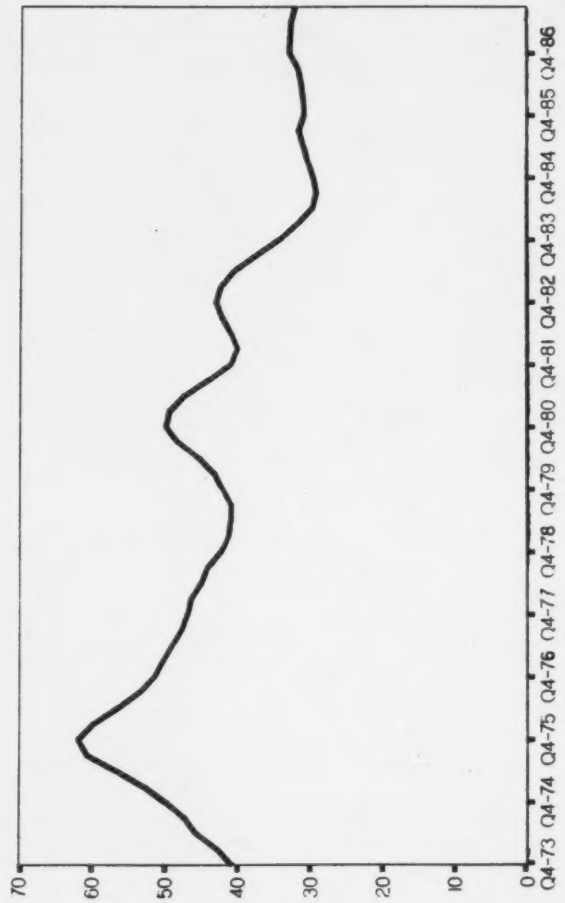
1. Senior Fellow, The Brookings Institution, Washington, D.C. I am grateful to Julie Gerber-Fields for exceptional help in preparing this testimony. The views expressed are solely my own and should not be ascribed to the staff or trustees of the Brookings Institution.

2. The values in the graph are computed as the four-quarter moving averages of the ratio of two numbers: the number of unemployed workers covered by continuing claims under all state and federal unemployment insurance programs and the number of civilian unemployed workers.

FIGURE 1. **UNEMPLOYED COVERED BY INSURANCE**

(PERCENT)



now apply for benefits when they lose their jobs. In part this is due to a change in unemployment insurance eligibility requirements, established both at the state and national levels. But it may also be due to the erosion in value of benefits for some unemployed workers. Second, the extended benefit programs are now far less significant than they were during the 1970s. Legislative changes enacted in the early 1980s made it harder for the Extended Benefit program to trigger on. In addition, the trigger mechanism became even more restrictive as an unintended side effect of the decline in the trigger unemployment rate--the insured unemployment rate or IUR--relative to the overall or civilian unemployment rate--the CUR.

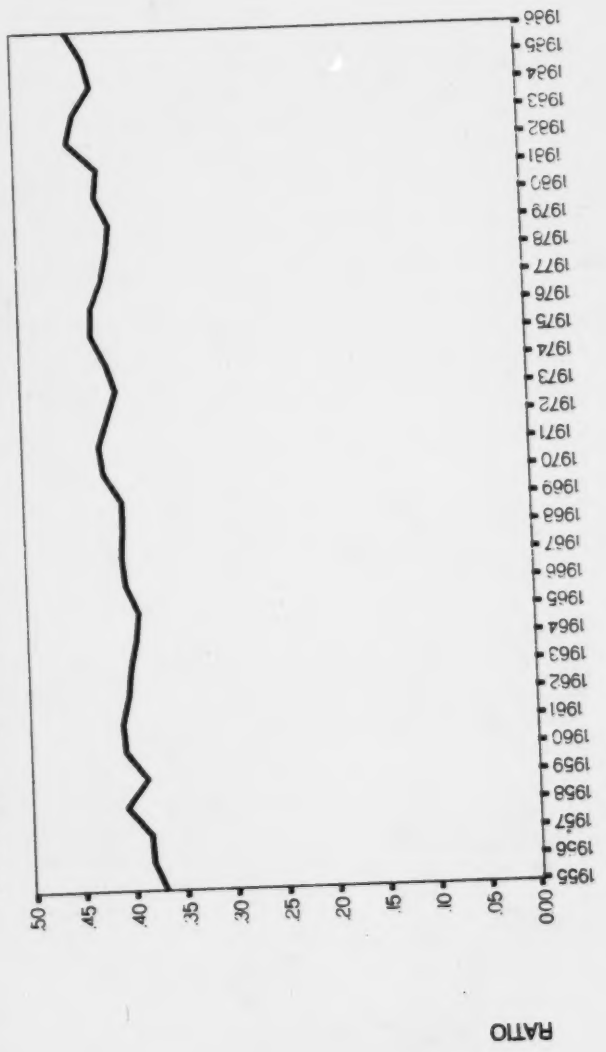
Though the percentage of unemployed workers receiving unemployment benefits has fallen, there is no evidence to suggest that the average benefit paid to a qualified worker has changed. In Figure 2 I show the level of average weekly unemployment benefits as a proportion of the average weekly wage paid to nonsupervisory employees. This proportion, which is usually referred to as the replacement rate, has remained quite stable since the early 1970s. The gross replacement rate measured in this way is now about 45 percent. However, the tax treatment of jobless benefits has changed significantly over the past decade. Unemployment benefits, which before 1979 were exempt from state and federal income taxation, are now fully taxed. If the average recipient of jobless pay faces a combined state and federal income tax rate of 20 percent, the value of unemployment benefits to an average unemployed worker has fallen by 20 percent since 1978. The decline in the after-tax value of insurance may be one reason that fewer unemployed workers now bother to apply for benefits.

In order to determine the exact magnitude of the decline in unemployment insurance coverage, it is necessary to examine a couple of statistics in addition to the simple coverage ratio shown in Figure 1. Under the U.S. system of jobless pay, benefits are not provided to all classes of the unemployed. New labor market entrants and most reentrants to the labor market are not eligible to receive benefits, because the program insures only those workers with recent job experience. In addition, workers who voluntarily leave their jobs may not be eligible for benefits or may be eligible only after a specified waiting period, such as 6 or 10 weeks. This means that the overwhelming majority of workers eligible for benefits will be those who are unemployed because they involuntarily lost their previous jobs. Under regular state insurance programs, jobless benefits are limited to the first 26 weeks of a spell of unemployment. Thus, few job losers unemployed longer than 26 weeks will qualify for insurance coverage.

To understand the changing relationship of unemployment insurance to the state of the economy it is therefore necessary to focus on the relationship between insurance coverage and the number of short-term job losers, defined here to include those job losers who have been out of work for fewer than 27 weeks. Figure 3 shows the ratio of two

FIGURE 2. **UNEMPLOYMENT INSURANCE REPLACEMENT RATE**

(AVERAGE WEEKLY BENEFIT / AVERAGE WEEKLY WAGE)



statistics that measure these concepts: the number of workers covered by continued claims under regular state unemployment insurance programs and the number of unemployed job losers who have been in unemployment 26 or fewer weeks. Figure 3 shows the recent trend in the four-quarter moving average of this ratio.

In previous research I have found that this coverage ratio remained quite stable over the thirteen years from 1967 through 1979.[3] During this period there were an average about 108 recipients of regular insurance benefits for every 100 job losers unemployed less than 27 weeks. This ratio fluctuated somewhat over the business cycle, as can be seen in Figure 3, but it was otherwise quite stable. (In fact, the ratio was probably quite stable even before 1967, but this cannot be ascertained with certainty because the Bureau of Labor Statistics did not determine the monthly count of job losers before 1967.)

Beginning in 1980 the ratio of insured unemployed to short-term job losers fell quite sharply. This coverage ratio reached an all-time low in the third quarter of 1984, when it fell to 71 insurance recipients for every 100 job losers. Since 1984 the coverage ratio has recovered somewhat, until now there are about 80 insurance recipients per 100 job losers. Nonetheless, the coverage ratio remains one-quarter below its average level over the period from 1967 through 1979, indicating that far fewer involuntary job losers now receive benefits than was the case during the 1960s and 1970s.

The exact reasons for the decline in the fraction of job losers collecting regular unemployment benefits are not clearly understood. One reason, as noted above, may be that the after-tax value of benefits has fallen as a result of the recent decision to tax insurance benefits. I also believe that both the states and the federal government have significantly tightened up on the administration of regular UI programs. None of the reforms has been so important that it would inspire newspaper headlines. But cumulatively, the changes over the late 1970s and early 1980s have reformed the system in such a way that eligibility conditions have been tightened and the attractiveness of benefit application reduced.

Some states may have become more restrictive as a result of tight fiscal constraints, resulting from the tax limitation movement of the late 1970s or the severe recession of the early 1980s, which depressed tax collections. In other states there has been a growing recognition that the federal government will not bail out those state unemployment

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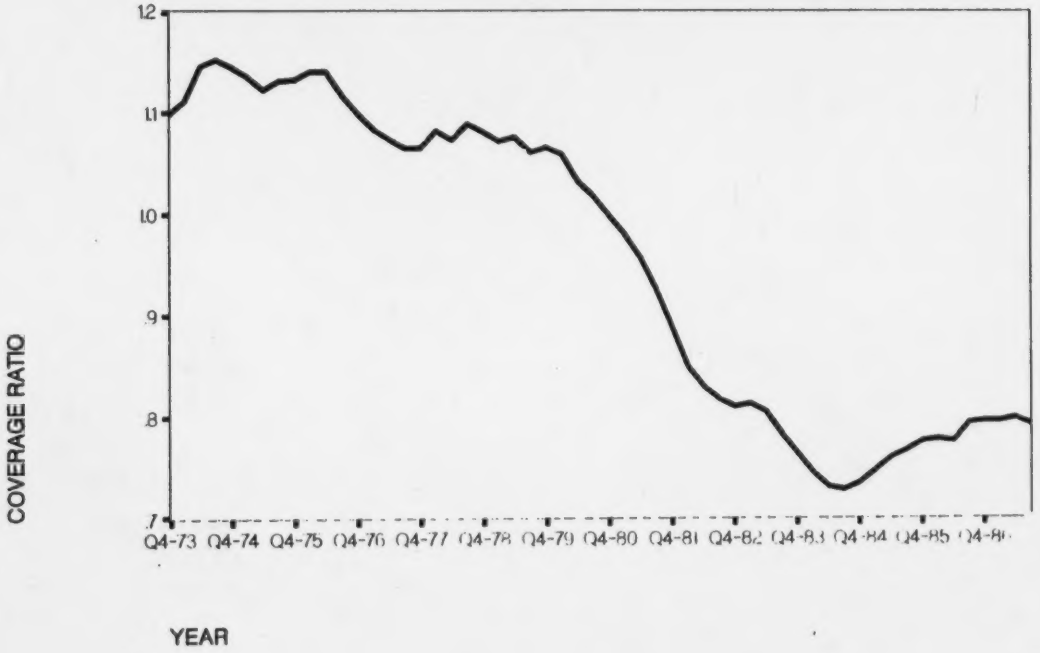
3. Gary Burtless, "Why Is Insured Unemployment So Low?" Brookings Papers on Economic Activity, 1983:1, pp. 225-53; and Gary Burtless and Wayne Vroman, "The Performance of Unemployment Insurance Since 1979," Proceedings, Industrial Relations Research Association, 1985, pp. 138-146.

FIGURE 3. **UNEMPLOYMENT INSURANCE COVERAGE RATIO**

(# COVERED BY REGULAR BENEFITS / # OF SHORT-TERM LOSERS)



funds which have been in severe deficit for more than a decade. Moreover, since the late 1970s, the federal government has adopted a less indulgent attitude toward states that continue to run deficits in their unemployment insurance trust funds. For example, states now pay interest on net new borrowings from the federal fund. During the 1970s, federal loans to state funds were interest free. State governments have been responsive to federal incentives to reduce their deficits, both through imposition of higher taxes and reductions in benefit outlays. The net effect has been reduced liberality in extending benefits to the newly unemployed.

Implications for Policy

Whatever the exact reasons for the drop in insurance coverage of new job losers, the decline has two kinds of implications for the unemployment insurance system itself and for the economy as a whole. First, the insured unemployment rate has become an extremely poor indicator of labor market distress. The IUR is simply the percentage of all workers covered by the unemployment insurance system who are currently collecting benefits under regular state programs. The 25-percent drop in the number of recipients under those programs relative to the number of job losers has been directly translated into a 25-percent drop in the IUR itself. As a result, the IUR has fallen sharply in relation to the civilian unemployment rate (CUR), which provides a far better measure of the state of the current job market.

The relationship between the civilian and the insured unemployment rates is shown in Figure 4. Although these rates tend to move in parallel fashion over the business cycle, they have drifted apart since 1955. Before 1980, this drift could easily be explained by the changing composition of the civilian unemployed (the unemployed were younger, less likely to be job losers, and increasingly drawn from industries with low levels of insurance coverage) or changing regulations about the insurance coverage of employed workers.[4] After 1980, however, the sharp decline in the IUR relative to the CUR has been almost entirely attributable to the drop in the fraction of new job losers collecting benefits.

Because the IUR is a poor indicator of the condition of the job market, it is a poor instrument for triggering state-level Extended Benefit programs. In view of the new relationship between the IUR and the CUR, it is clear that if the IUR trigger rate is left unchanged the Extended Benefit program will be triggered at a later stage of a future recession--if it is triggered at all--and would be turned off at a much earlier stage of an economic recovery. This is precisely the sequence of events observed during the 1981-82 recession. In a future recession, the inadequacy of the Extended Benefit trigger will be even more

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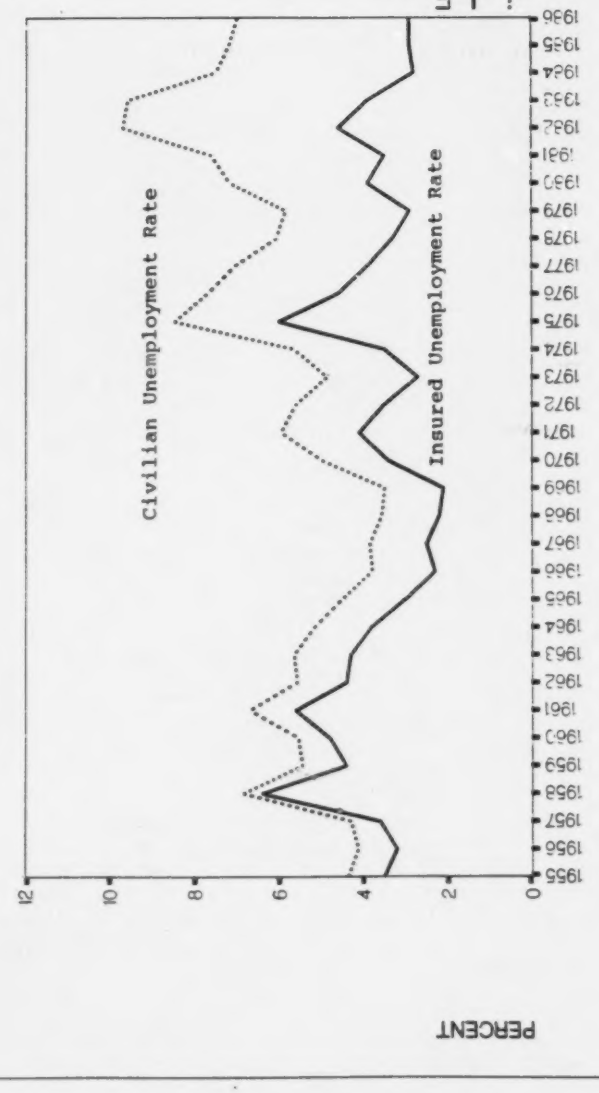
4. See Burtless, "Why Is Insured Unemployment So Low?", pp. 233-34.

FIGURE 4. INSURED UNEMPLOYMENT RATE VERSUS CIVILIAN UNEMPLOYMENT RATE



conspicuous, because the IUR has continued to decline in relation to the CUR since the early 1980s.

A second important implication of these developments is that the unemployment insurance system has become a much weaker source of counter-cyclical stimulus during economic downturns. The effectiveness of the Extended Benefit program has been reduced by at least half as a result of the deterioration in the IUR trigger mechanism. The stimulus provided by regular insurance programs has dropped by one-quarter because of the decline in the number of recipients relative to unemployed job losers. And the stimulus provided under both the regular and extended benefit programs has dropped by an additional 15-20 percent since 1978 as a consequence of the taxation of insurance benefits. In comparison to the level of counter-cyclical stimulus available during the late 1960s and 1970s, the stimulus arising from the existing system is at least 40-45 percent lower.

At a minimum there appears to be a compelling case for reforming the trigger mechanism in the Extended benefit program. In addition, there is a reasonably good case for raising the after-tax value of current benefits. The value of these benefits was reduced when insurance first became taxable in 1979 and was eroded still further in January of this year when payments were made fully taxable. Although there are good equity reasons for treating unemployment insurance benefits exactly as we treat other forms of income, no good reasons were suggested for reducing overall income protection during spells of unemployment by 15 or 20 percent. Yet this reduction occurred as an unintended side effect of eliminating the long-established exemption of unemployment benefits from income taxation. Not only was income protection slashed, but the value of unemployment insurance as a counter-cyclical stimulus was reduced.

Reforming the Trigger Mechanism for Extended Benefits

Any substitute for the IUR in triggering extended jobless benefits should meet three criteria, as I have pointed out in previous testimony before this committee. It must specifically reflect the labor market situation of persons insured by the program. It must be available in a timely manner, either weekly or monthly. And it must be available on a state-by-state basis, because the U.S. insurance program is a joint federal-state system that is largely managed at the state level. The civilian unemployment rate (CUR) and the job loser rate (the number of job losers as a percentage of the civilian labor force) meet the first two of these criteria better than the current trigger rate--the IUR. The job loser rate is probably preferable to the CUR because it provides a better reflection of the job market prospects of unemployed workers actually insured by the program.

But neither the CUR nor the job loser rate meets the third criterion. The Current Population Survey (CPS), which is the source of

monthly information used to compute the CUR and job loser rate, is based on a sample that is too small to permit accurate estimation of the number of unemployed workers or job losers in each state. The information from a single monthly survey could be combined with data from several previous surveys in order to form a more accurate estimate of state unemployment or job loser rates. But this procedure suffers from the disadvantage that the weighted average of past monthly unemployment rates moves much more sluggishly than the unemployment rate itself. Thus, the moving-average of past monthly unemployment rates would not necessarily provide a timely trigger mechanism for the Extended Benefit program.

Given present limitations on state-level unemployment data, the best trigger mechanism must depend on a combination of information about overall state unemployment, as reflected in the Current Population Survey, and insured unemployment, as indicated by the IUR. Fortunately, we already possess such an indicator in the Bureau of Labor Statistics' monthly or bimonthly estimates of state-level unemployment rates, which are based upon both CPS and insured unemployment data. An alternative mechanism would rely on the CPS estimate of the national job loser rate to determine the national average duration of Extended Benefits, but would rely on the current trigger mechanism to determine the precise number of Extended Benefit weeks that would be available in each state. Either of these mechanisms is preferable to the current procedure, which places exclusive reliance on the IUR as a trigger for state Extended Benefit programs.

In whatever way Congress decides to reform the trigger mechanism for the EB program, it should be aware that the U.S. unemployment insurance system is far smaller and less significant than it once was. The main cause for the contraction of the system has been a decline in the number of recipients of regular insurance benefits relative to the number of men and women on temporary or permanent layoff. A vital task for policymaking over the next few years is to restore the ability of the nation's unemployment insurance programs to deal with severe recession. A worthwhile beginning in this task would be a concerted effort to improve the triggering mechanism for extended unemployment benefits.

Mr. PEASE. Thank you very much, Mr. Burtless.
Mr. Vroman.

STATEMENT OF WAYNE VROMAN, SENIOR RESEARCH ASSOCIATE, THE URBAN INSTITUTE

Mr. VROMAN. Since the previous speaker has set a precedent for being brief, I will try to follow in that spirit.

You have five questions around which our remarks are to be focused. I initially want to say some general things about unemployment in the economy and then come back to selected questions on your list.

The first point is that the U.S. economy in the 1980's has experienced very high levels of unemployment—high by any kind of historic comparison covering the entire post-World War II period. For the 8 years 1980 to 1987, the average unemployment rate has been 7.7 percent of the civilian labor force.

The only time the unemployment rate ever got to that level prior to 1979 was in the trough of the recession of the midseventies, so we're skating on new ground.

Unemployment insurance pays benefits when there are occurrences of unemployment in the economy. So if you move into a new era with much higher unemployment rates, you're bound to have a program that pays out a lot more benefits.

Also in the 1980's, two other aspects of unemployment are very obvious in the data from the current population survey.

First of all, the unemployment rates for adult males, many of whom are family heads with income needs for families going beyond just their own individual needs, have been unusually high when compared to unemployment rates in the 1970's and in the late 1960's. Throughout this decade their rate has been almost 80 percent of the overall unemployment rate for people 16 and older.

Also unusual in the present decade has been the amount of long-term unemployment measured as the number of people unemployed 27 weeks and longer. The long-term unemployment rates of this decade are unprecedented.

Now, those facts about unemployment mean that the UI program has been subjected to unusually heavy demands for benefits. The demands for benefits have occurred in an environment where financial incentives from the Federal Government have been for the programs basically to balance the books rather than pay benefits.

As a result, the States have been very successful at balancing the books. They have been very unsuccessful at paying benefits.

And if you look at the ratio of the insured rate to the total rate, that's one way to show the decline in the size of the program. The number of claimants, the amount of benefits paid in long-term unemployment programs—there are several other indicators. They all go in the same direction.

The high amount of long-term unemployment in this decade is not really a mystery. The first of these figures that I handed to you, Congressman, is a regression equation—figure 3—which shows the proportion of the unemployed who are unemployed 27 weeks and longer.

In aggregate national data, that proportion can be explained in an equation that was fit through the end of the 1970's using mainly two variables—this year's unemployment rate and last year's unemployment rate. When the unemployment rises, there is a tendency for long-term unemployment to stay around longer than overall unemployment.

Consequently, the highest levels of long-term unemployment occur 1 year after the trough of a recession. That is, in the mid-seventies it was 1976, not 1975. In the 1980's it was 1983, not 1982. The equation in figure 3 that was fit through 1979 makes very good predictions from 1980 through 1987.

Now, in contrast to that, figure 4 shows how the UI program has fared paying benefits to people who are unemployed. The ratio of insured to total unemployment was explained in a regression that went through the year 1979. The regression had very good explanatory power for the period when it was fit.

When when it was used to predict the payments of unemployment benefits in the 1980's you can see how the dotted lines in figure 4 depart increasingly from the solid lines. The solid lines are the IU/TU ratios, and the dotted lines are the predicted ratios from the equation. The UI system has shrunk relative to what one would have been expected based on the experience of the preceding 35 years.

That's not trivial, because there is a very strong association between unemployment—and particularly long-term unemployment—and occurrences of poverty. In the longer statement I have data from 1976 and 1983 arranging people by their unemployment duration and the probability of being in poverty, measuring poverty before the receipt of transfer payments and after. The short story here is the longer you're unemployed, the higher the likelihood of being in poverty. For people unemployed for 40 weeks and longer, the chance of poverty is 60 percent before transfer payments are received. In the midseventies the unemployment insurance program was able to reduce, for the people who collected, poverty rates from 60 percent to about 35 percent.

In the 1980's—1983—the poverty-reducing effectiveness of UI was sharply lower, so the poverty rates for the very long-term unemployed were only reduced by about 25 percent.

It seems to me that many people when they talk about UI view it as a very technical kind of program that pays benefits to some people and not to others, and probably they both will get along reasonably well if they don't get the benefits.

For the long-term unemployed, however, the most effective single poverty-reducing program that exists is unemployment insurance. That's why the program was founded in the first place. And to the extent that it pays benefits particularly targeted on the long-term unemployed, that's where it should be paying its benefits.

What has happened in the 1980's? UI has been cut back, and it has been cut back most sharply in the area of long-term benefits. Consequently, the ability of the program to reduce poverty among the long-term unemployed has been sharply eroded in the present decade.

Another thing one can examine with unemployment data from the last 20 years is the way that within the overall business cycle

of the U.S. economy, unemployment also has a regional aspect which moves around from region to region.

Examples: In the 1970's the region that was most hard hit by the recession was the Northeast—New England, the Middle Atlantic States, New York, New Jersey, Pennsylvania. In the 1980's—particularly the early years of the 1980's—it was the industrial States in the Midwest, as you know. I'm not telling you anything on that. In the last couple of years unemployment has again moved around to the energy-producing States. If you examine Louisiana, Texas, Oklahoma, Wyoming, Colorado, New Mexico—all of those States have had major increases in their unemployment rates.

The system has individual States financing the programs but not knowing exactly what kinds of obligations they are facing in future years. One thing we do know based on the unemployment data from the last 20 years is that superimposed on the overall business cycle is a movement of regional unemployment rates around the national rate.

I have already said some things about how UI has been cut back in the 1980's. Much of the incentive for the cutbacks has come from the Federal Government.

Let me now turn to the odd-numbered of the five questions in the handout—the adequacy of UI reserves first.

Suppose we were to think about a recession starting next year. Then it would make sense to compare the level of the trust fund now with what existed at the end of 1979, since that predated the recessions of the 1980's.

The absolute dollar amounts are as follows: At the end of 1979, total UI trust fund reserves were a little less than $9 billion. Now they're up to $23 billion.

As a percentage of covered payroll, the UI system is now more adequately financed. At the end of 1979 reserves were 0.92 percent of covered benefits. Now they are 1.3 percent of benefits—of wages. So as a percent of wages, the system has more benefit potential in the trust funds.

The UI program has been cut back, so the potential claims if we go into a recession will be somewhat lower.

It's my expectation that if we had another recession we wouldn't see the volume of borrowing that occurred in the early 1980's, but we still would have several States which currently have very low trust fund balances that would go into debt very quickly.

Parenthetically, I have to say that for someone from Illinois to suggest that they will essentially go with a pay-as-you-go UI program so that when they go into a recession they are going to go to their employers and say, "surprise"—I think that is just exactly the wrong way for UI to be financed. It should be financed ahead of time when you have good economic times, not in the bad times when your employers are having very low profits.

It is very likely to see a world where Illinois goes to their employers, and lo and behold, the State legislature comes up with a bill that says, "Well, we'll just defer these a little bit further."

So I don't think pay-as-you-go financing, which is what the Illinois proposal is, deserves to get off as easily as you and the other members of the panel have allowed.

Now, on the question of EB—you may have had your staff look at this, but I have taken the 9 percent unemployment rate—the minimum threshold of the TUR from your bill. We have had now enough years of the current EB program to assess it, in particular the last 3 years where we have full annual data.

In 1984 when the national unemployment rate was 7.5 percent, 14 States had a TUR of 9 percent or higher. So 14 States would have triggered to the 10 weeks of EB in your bill.

How many paid EB actually in 1984? Four—and only of three of the States that had a TUR above 9 percent.

In 1985 you had seven States with a rate above 9 percent. Only four paid EB.

In 1986 as the recession went South, a lot of Southern States started to experience very high unemployment rates. Nine States had a rate above 9 percent. Only three paid extended benefits.

So I think in terms of targeting benefits toward the group that needs them—the long-term unemployed—your bill has a lot to commend it.

The comment that you made to Grace Kilbane about rolling the TUR over for several months obviously takes care of many of the problems of its short-term variability. When you see the TUR sitting above 10 percent for 1 year or 2 years, that variability argument loses all of its real thrust.

For ICESA, which I view as a somewhat conservative organization, to dismiss the TUR I think is better news for employers than it is for workers in the U.S. economy.

Finally, question No. 5 on alternative uses of UI trust fund moneys. I view the problem as one of income maintenance and, then, alternative uses.

The UI programs in many States right now cannot meet their income maintenance needs or obligations. I think you should combine some sort of solvency standard with alternative uses proposals. That is, it's fine for a State to have alternative uses, as California has had for several years, and many other States are now moving in that direction, if you have a trust fund that is large and robust.

To propose an alternative uses program in Illinois, Ohio, or Michigan, where the current trust funds really can't handle the benefit claims that will come in in the next recession is not wise. It seems to me the financing associated with alternative uses might better be a Federal than a State responsibility. But, if States want to innovate, as Massachusetts, comments of earlier, Massachusetts is in perfect shape to do that. They've got a very low TUR, they've got lots of possibilities for having people find alternative jobs if they get training and other skill enhancements.

So, I think that alternative uses is a very good idea, but, basically, making sure your funds are big enough to cover your benefit claims also is a good idea.

Thank you.

[The statement of Wayne Vroman follows:]

STATEMENT OF WAYNE VROMAN

I would like to thank the subcommittee on Public Assistance and Unemployment Compensation for the opportunity to share some observations about unemployment and the State Unemployment Insurance (UI) program this morning. My remarks will focus on four areas; (1) the level of unemployment in the 1980s, (2) cutbacks in the availability of UI benefits, (3) the link between UI benefits and poverty and (4) the link between UI funding problems and cutbacks in benefit availability. In each area there are tables with backup data which support the comments to be made.

I. THE LEVEL AND COMPOSITION OF UNEMPLOYMENT IN THE 1980s

The U.S. labor market in the 1980s has experienced very high levels of unemployment, spite the sustained economic expansion of the past five years the overall unemployment rate for persons 16 and older has remained at 6 percent in the last half of 87. Column (1) of Table 1 shows that annual unemployment rates equaled or exceeded 7 percent every year between 1980 and 1986. Between 1948 and 1979 annual unemployment rates ceeded 7 percent in just three years, the high unemployment years from 1975 through 1977.

Two other aspects of unemployment in the 1980s should also be emphasized. The high unemployment has been shared by all groups in the labor force including men aged 25 and older who usually have the lowest unemployment rates of all the age-sex groups. Annual unemployment rates for these men have equaled or exceeded 4.8 percent for each year in the 1980s (column (2) of Table 1) whereas their rate had equaled or exceeded 4.8 percent in just five prior years; the recession years 1949, 1958, 1961,1975 and 1976. Since 1982 the relative unemployment rate for men 25 and older (their rate as a proportion of the overall unemployment rate) has ranged from .74 to .80 whereas in the 1970s their relative unemployment rate ranged from .53 to .64 and averaged .58. Adult men have experienced very high relative as well as high absolute unemployment rates in the 1980s.

The 1980s have also been characterized by usually high levels of long-term unemployment. The annual average of persons reporting unemployment duration of 27 weeks and over has exceeded 1 million persons each year since 1981 (column (5) of Table 1). Long term unemployment increased from 1.07 percent of the labor force in 1981 to 2.29 percent in 1983, and it then declined to .88 percent of the labor force in 1987. Unemployment data for the first eleven months of this year show that persons unemployed 27 weeks and over accounted for 14 percent of unemployment in 1987. The persistence of such high long term unemployment percentages in recent years is most unusual (column (3) of Table 1).

Although long term unemployment has been usually high in the 1980s, it has a relatively straightforward explanation, i.e. the high levels of overall unemployment. A regression covering the years 1949 to 1979 explained 91 percent of the variation in the long term unemployment proportion (those unemployed 27 weeks and over as a proportion of all unemployed persons) using just the current year's unemployment rate and therate from the previous year. Both unemployment variables had large positive coefficients. When unemployment rises, the proportion that is long term also rises. The regression suggested that each percentage point increase in the unemployment rate would cause the long term unemployment proportion to increase by .03 to .04. This regression made highly accurate projections of the long term unemployment proportions for the eight years from 1980 to 1987. The average projection error for the eight years was .003 and the standard error of the projections (.0137) was only slightly larger than the standard error for the 1949-1979 estimation period (.0116).

To summarize, unemployment in the 1980s has been usually high, high among all demographic groups, and, for many workers, the spells of unemployment have been of very long duration. The long duration of unemployment in the 1980s has been due largely to the high average level of unemployment.

II. CHANGES IN UNEMPLOYMENT INSURANCE BENEFIT AVAILABILITY

The 1980s have also been characterized by reductions in the availability of State UI benefits. One indicator of UI benefit availability that is frequently cited is the ratio of insured unemployment to total unemployment. Insured unemployment which reflects the number of claimants for regular state UI benefits has traditionally averaged from 36to 50 percent of total unemployment. The insured-to-total or (IU/TU) ratio(column (7) of Table 1) averaged .402 for the decade of the 1970s. For the past five years, however, the ratio averaged only .305.

Since other witnesses will also comment on the recent declines in insured unemployment, I will not dwell at length on this point. Regression analysis that I have done and research done by Dr. Gary Burtless at the Brookings Institution both show that the cumulative reduction in the IU/TU ratio since 1979 has been at least thirty percent. Research conducted to date has not found a fully satisfactory explanation for the decline in insured unemployment. A project presently underway at Mathematica Inc. may provide important insights into this question.

To help quantify the extent of the reduced UI benefit availability, however, I have fitted some regressions to explain the IU/TU ratio (column (7) of Table 1) over the 1949-1979 period. About 88 percent of the variation in the IU/TU ratio was explained using three variables; the current year's unemployment rate or TUR (a positive effect), the lagged TUR (a negative effect reflecting the influence of both exhaustions and reduced base period earnings credits) and an unemployment mix variable (the relative unemployment rate for men 25 and older to reflect their greater propensity to collect UI benefits). The regression had an average error of .021 for the 1949-1979 estimation period. When it was used to project IU/TU ratios from 1980 to 1987, however, it overpredicted for all eight years. Seven of the eight overpredictions exceeded .05 and the eight year average overprediction was .064. Since the actual IU/TU ratios averaged .337 between 1980 and 1987, these overpredictions are very large. There clearly has been a major reduction in UI benefit availability in the 1980s.

To provide some detail on the cutbacks in State UI benefit availability, Table 2 shows annual data on benefits paid by the regular UI programs as well as Federal-State Extended Benefits and benefits from temporary federal programs (e.g., Federal Supplemental Compensation from late 1982 to early 1985). The table shows the absolute dollar amounts of benefit payments and benefits measured relative to the growth trend in GNP. The latter percentages, columns (5) - (8) in the table, are most relevant since they adjust both for changes in the level of real economic activity and inflation.

Three points that are supported by the data in Table 2 should be emphasized. (1) Regular State UI benefits have not been a higher percentage of trend GNP in the 1980s when compared to benefits of the mid 1970s (the previous recessionary period) despite the higher unemployment rates experienced in recent years (column (6)). For example, the percentages paid as regular State UI benefits were essentially the same in 1976 as in 1983 even though the overall unemployment rate was 7.7 percent in 1976 compared to 9.6 percent in 1983. (2) Benefits for long term unemployment have been less available in the 1980s compared to the mid 1970s. Long term benefits (Federal-State Extended Benefits (EB) plus benefits from temporary federal programs) represented .28 percent of trend GNP in both 1975 and 1976 (columns (7) plus (8)). The highest corresponding percentage from the 1980s was .20 percent in 1983. Availability of long term benefits was considerably greater in 1983 than in 1982. Since the long term unemployment rates were 1.61 and 2.29 percent in 1982 and 1983 respectively the need for such benefits was higher in these years than in 1975-76, but they were much less available. (3) After the EB triggering mechanism was changed in two stages in 1981 and 1982, long term UI benefits in the 1980s were paid mainly through the temporary Federal Supplemental Compensation (FSC) program. Only five states (Alaska, Idaho, Louisiana, West Virginia and Wyoming) plus Puerto Rico paid EB benefits at any time between January 1984 and November 1987. Since FSC expired in early 1985 there is now practically no chance that unemployed workers would receive long term UI benefits.

III. UNEMPLOYMENT, UNEMPLOYMENT INSURANCE AND POVERTY

Two important features of the U.S. labor market in the 1980s have been (1) the large amount of long term unemployment, and (2) the reduced availability of State UI benefits, particularly benefits paid to the long term unemployed. This section examines the tabulations of the U.S. Census Bureau's Current Population Survey (CPS) for the years 1976 and 1983. The purpose of the analysis is to describe the economic status of the long term unemployed and to explore the effects of State UI benefits and other transfers on their economic status. Attention is focused on those with the longest unemployment durations.

Long term unemployment is measured in two different ways in the CPS. The monthly labor force survey asks questions about the duration of the current unemployment spell for each unemployed household member. Averages based on the 12 monthly survey responses to this question appear in column (5) of Table

durations had pre-transfer poverty rates of 8.9 percent and 11.1 percent in the two years respectively. Second, the poverty-reducing effectiveness of UI and other transfers was lower in 1983 than in 1976. For nine of the ten comparisons that can be made in the bottom two panels of the table, the 1976 poverty rate reduction was larger than the 1983 reduction. Third, and most important, the diminished effectiveness of UI benefits in reducing poverty rates in 1983 is most apparent among workers with long unemployment durations. For those unemployed 40-50 weeks and 51-52 weeks poverty rates among UI recipients were reduced by 35-38 percentage points in 1976 but by only 23-25 percentage points in 1983. This finding is hardly surprising given the reduced availability of UI benefits generally and of long term UI benefits in particular in 1983 compared to 1976.

IV. EXPLAINING THE REDUCED BENEFIT AVAILABILITY

Changes in the availability of regular UI benefits during the 1980s have been in part due to financing problems experienced by UI programs. Many state programs borrowed from the U.S. Treasury in the recession of the mid 1970s, but the cost of borrowing rose sharply when new federal loans started to carry interest charges in April 1982. Since that date, states with large debts owed to the U.S. Treasury have deliberately restricted benefit eligibility in order to reduce indebtedness and to receive more favorable loan repayment terms. These state actions were particularly noticeable around the time of the 1983 Social Security Amendments which offered an explicit quid pro quo: easier debt repayment terms in return for state legislation that both raised taxes and reduced benefits. Benefit restrictions have also been enacted in 1984-86, particularly in many energy-producing states.

Throughout most of the 1980s the four states with the largest UI debts have been Illinois, Michigan, Ohio and Pennsylvania. At the end of September 1987 their combined indebtedness to the U.S. Treasury stood at $2.48 billion. In contrast, four states with very large trust fund reserves (California, Florida, Massachusetts and New York) had a combined fund balances of $9.48 billion on the same date. Table 4 presents national data along with data from these eight states to illustrate contrasts in recent cutbacks in UI benefit availability. The ratio of insured to total unemployment (IU/TU) is used as an index of benefit availability. This ratio averaged .379 in national data in 1978-79 but it declined by .067 to .312 in 1985-86 (Recall column (7) of Table 1.)

Between 1978-79 and 1985-86 the IU/TU ratio declined by more than .067 in all four of the debtor states in Table 4. The average decline in the ratio was .137 nearly twice the decline registered in the national data. For each of the four states with large trust fund balances the insured-to- total unemployment ratio declined by less than .067 and the average decline for the four was only .003. In Massachusetts and California the ratio was actually higher in 1985-86 than in 1978-79.

It is hardly surprising that benefit availability (as indicated by the IU/TU or insured-to-total unemployment ratio) should have declined more rapidly in the four debtor states. All four passed major UI laws in late 1982 or early 1983 to improve the fiscal solvency of their programs. Additionally, three of the four (all but Ohio) had previously restricted benefit eligibility through legislation passed in 1980 or 1981. As a consequence of their 1982-83 actions each of the four states qualified for easier federal loan repayment terms (deferred interest payments and reduced Federal Unemployment Tax penalty taxes in all four plus lower interest rates in three of the four). The types of actions that were taken included: (i) freezes or actual reductions in maximum weekly benefits, (ii) increased waiting periods, (iii) reduced maximum potential benefits durations, (iv) higher base period earnings requirements and (v) more stringent disqualification penalties. The benefit cutbacks resulting from the 1982-83 legislation were not small. At the time of enactment it was estimated that the savings in benefit outlays over the 1983-86 period would be as follows; Illinois-$780 million, Michigan-$1082 million, Ohio (for 1983-85)-$351 million and Pennsylvania-$569 million. The estimated annual savings of $727 million caused by these actions represented 15 percent of actual benefit outlays made from the four state trust funds in 1983, a year of very high benefit payments.

Table 4 shows that the four large debtor states have continued to experience high unemployment into 1985 and 1986. Their average 1985-86 unemployment rate was 8.5 percent, 1.4 percentage points above the national average of 7.1 percent. Because high unemployment rates are associated with long duration spells of unemployment, these four states accounted for 21 percent of national unemployment in 1985-86 but 29 percent of unemployment

lasting 27 weeks and over. Long duration spells lead to more benefit exhaustions among UI recipients. Thus the sharp declines in insured unemployment in the four states are probably influenced by high rates of benefit exhaustions. The recent losses of basic industrial jobs in these same states may also have contributed to the sharp recent declines in insured unemployment. To my knowledge no one has successfully distinguished the individual effects of statutory changes in UI eligibility from the effects of benefit exhaustions and changes in the mix of jobs by industry and region in contributing to the recent reductions in the ratio of insured unemployment to total unemployment. The project underway at Mathematica Inc. should provide important insights into the relative importance of the different factors contributing to the reduction in the IU/TU ratio.

A useful perspective for understanding the behavior of the IU/TU ratio in the 1980s is provided by regional data on total unemployment and insured unemployment. Since 1967 the U.S. Department of Labor has published regional data from the CPS on civilian employment and unemployment for the four Census regions and nine Census divisions. Table 5 shows average TURs by geographic area as well as national data for three periods; 1967-69, 1970-79 and 1980-86. These data are useful for illustrating how regional unemployment experiences have varied within the overall unemployment experience of the U.S. economy.

Because 1967-69 was a period very strong labor demand all regional unemployment rate averages grew between 1967-69 and 1970-79. While the national average TUR grew by 2.58 percentage points or by 70.9 percent, however, regional unemployment rate growth demonstrated considerable diversity. The average TUR of the 1970s grew most in the New England and Middle Atlantic states and least in the West North Central, South, and Mountain states.

Sharp regional contrasts are also apparent in the unemployment changes between 1970-79 and 1980-86. The 1980s have been years when average unemployment grew most rapidly in the Midwest and East South Central states. Average TURs have declined in New England and growth was also slow in the Mid-Atlantic and Pacific states. The data in Table 5 clearly illustrate that regional economies do not move in lock step with the national economy. Even greater regional variation would be apparent if 1985-86 was distinguished from 1980-84 in Table 5. The extent of the recent labor market deterioration in the West South Central and Mountain states would then be apparent.

Interregional contrasts in unemployment patterns would be of less interest for present purposes if unemployment insurance (UI) in the United States was structured and financed as a national program and/or if IU/TU ratios were similar across states. In fact, the IU/TU ratios of the individual state programs are quite varied. Table 6 provides details on IU/TU ratios by region for three periods 1968-69, 1978-79 and 1985-86. From data in this table, several consistent patterns are observed. The IU/TU ratios are highest in New England, Mid-Atlantic and Pacific states. They are lowest in South Atlantic, West South Central and Mountain states.

The patterns of change in Table 6 also suggest that changes in TURs, particularly 1980-86 relative to 1970-79, have an influence on IU/TU ratios. Between 1968-69 and 1978-79 IU/TU ratios rose in most areas, but they declined in New England, Mid Atlantic and Pacific states (states where the 1970-79 TURs increased sharply our 1967-69 TURs). In comparing the 1985-86 IU/TU ratios with 1978-79 ratios the largest proportional declines were in the East North Central, West North Central and East South Central states. These are the states where the 1970-79 to 1980-86 increases in the average TURs in Table 5 were the largest. Conversely the smallest changes were the smallest. Across the nine Census divisions the correlation between the change in the IU/TU ratio and the growth in the average TUR of the 1980s was -.86. Clearly IU/TU ratios have declined most in the 1980s in areas where TURs have increased the most.

An explanation for the behavior of the IU/TU ratios in the 1980s is as follows: (1) Many states entered the decade with low UI trust fund balances. (2) The states in the 1980s recognize that they have sole responsibility for financing UI benefit payments. Unlike the environment of the 1970s, soft (interest free) loans and/or debt forgiveness from the federal government are not realistic possibilities. (3) Because of low trust fund balances, increases in unemployment led to UI financing problems in many states. (4) The typical state response to the financing problem was to raise employer taxes and cut benefits (through both statutory changes in the UI law and administrative procedures). The experiences of several large industrial

1. There were between 1.0 million and 1.3 million persons unemployed 27 weeks and longer in the years 1975 to 1977. The corresponding annual averages ranged from 1.6 million to 2.6 million during 1982-1984. As noted earlier in Section I, both in absolute numbers and as a percent of the labor force there were more long term unemployed workers in 1982-84 than in 1975-77. Note also that the peak year for long term unemployment in 1975-77 was 1976 whereas the peak year in the 1980s was 1983.

A second CPS measure of long term unemployment is based on responses to the so-called work experience survey conducted in March of each year. The March survey asks questions about total weeks of unemployment during the previous calendar year and combines unemployment from all spells experienced during the year. Because durations from all spells are combined, the work experience data show more long term unemployment than do the annual averages based on the twelve monthly surveys. The work experience data indicate that more than 4 million persons were unemployed 27 weeks and longer in each year of the 1975-77 period while more than 6 million had such long durations in 1982 and 1983 and about 5 million in 1984. Like the annual averages, the work experience data show there was relatively more long term unemployment during 1982-84 than during 1975-77. For example the proportions unemployed 27 weeks and longer in work experience data were .212 in 1976 but .270 in 1983.

The March CPS questionnaire also includes a set of questions about the detailed income sources of each family member. One of the transfer payments that is identified is UI benefits. Overall, about one third of the unemployed report receiving UI benefits. When the proportions receiving UI benefits are arrayed by unemployment duration it is clear that recipiency proportions are lower in the shortest (1-13 weeks) and longest (40-52 weeks) unemployment duration categories. The recipiency proportions in the 40-52 weeks duration category also reflect changes in long term benefit availability as discussed earlier. Recall from Table 2 that UI benefits were more available in 1975-76 than in the 1980s. Also recall that combined EB-FSC payments were much higher in 1983 than in 1982. In the longest duration category (40-52 weeks) the recipiency proportions were .376 in 1976, .258 in 1982 and .329 in 1983.

The income status of the unemployed in 1976 and 1983 is examined in These two years were selected because they had the highest amounts of long term unemployment in the recessionary periods of 1974-76 and 1980-83 respectively. The table shows poverty rates for unemployed persons with poverty status measured in two ways; prior to the receipt of any transfer payments and after counting all transfer payments received. It displays weighted counts of unemployed workers and poverty rates disaggregated by UI benefit status and unemployment duration. There is a strong positive association between unemployment duration and the poverty rate in both years. In 1976, for example, the pre-transfer poverty rate increased from 17.1 percent for those unemployed 1-13 weeks to 59.9 percent for those unemployed 51-52 weeks. This association reflects the importance of earnings in determining family income and poverty status. Family income is reduced by larger amounts as unemployment duration increases.

Unemployment insurance and all other transfers each have measurable effects in reducing poverty rates. Reductions in poverty rates due to both transfers increase as unemployment duration increases, but the gradient in reducing the poverty rate is much steeper for UI benefits. In 1976, for example, both types of transfers reduced poverty rates by 4 to 5 percentage points among workers unemployed 1-13 weeks. Among those unemployed 51-52 weeks, however, the poverty rate was reduced by 38.8 percentage points when UI benefits were received but by only 13.2 percentage points when UI benefits were not received.

Note also in Table 3 that UI recipients generally had lower pre-transfer poverty rates than nonrecipients with the same unemployment duration. Thus, UI beneficiaries have lower post-transfer poverty rates both because their pre-transfer poverty rates were lower and because UI benefits caused larger reductions in poverty rates than among nonrecipients of UI. Overall, transfer payments reduced the poverty rate from 20.7 percent to 7.5 percent among UI recipients in 1976 while they reduced the poverty rate from 25.5 percent to 18.8 percent among nonrecipients of UI.

In comparing the poverty-reducing effectiveness of transfer payments between 1976 and 1983 three things are apparent in Table 3. First, the unemployed were generally somewhat poorer in 1983 than in 1976. For each of the five unemployment duration categories (among both recipients and nonrecipients of UI), the 1976 pre-transfer poverty rate was lower than the corresponding rate in 1983. For example, recipients of UI with 1-13 week

states in 1982-83 and, more recently, the energy-producing states illustrate that program cutbacks can occur even while a state's economy is in a recession. (5) The result is that benefits from the UI program decline proportionately more in those states that experience the largest increases in unemployment (whose citizens experience the largest increase in the need for UI benefits). This outcome is opposite from the intent of those who founded State UI more than fifty years ago.

To prevent a recurrence of these developments in a future recession, it seems clear that UI programs need to be more adequately financed. Larger trust fund balances need to be encouraged (should one suggest federal solvency standards?) and/or the taxing capacity of the programs should be increased. The latter can be accomplished by a combination of the following measures: i) raising the taxable wage base (by a substantial amount above the present $7,000 base for the Federal Unemployment Tax), ii) indexing the taxable wage base, iii) instituting an automatic solvency tax (triggered by low trust fund balances in reserve ratio states or high benefit payouts in benefit ratio states) and/or iv) increasing the range of experience-rated tax rates. The substantial trust fund building of the past four years means that net trust fund balances are now more adequate than in 1979, but they are still very low (or negative) in several large states.

V. CONCLUSIONS

Two traditional objectives of unemployment insurance are to reduce the size of income losses experienced by workers (and their families) when there is unemployment and to provide automatic stability to the overall Achievement of both objectives requires that benefit payments increase sharply during recessions. Although aggregate payouts from all UI programs did increase in the recessions of 1980 and 1981-82, the size of the increase (relative to trend GNP) was considerably smaller than what had occurred in previous recessions. Benefit availability was deliberately reduced in the 1980s while the economy was in recession. Major causes for the benefit cutbacks were federal and state policy actions. Important federal actions included charging interest on UI loans made to states after March 1982 and changing the EB triggers. State legislation designed to improve program solvency also reduced benefit availability. Because of the cutbacks, UI has been less successful in the 1980s than previously in achieving its traditional micro (family level) and macro (automatic stabilizing) income maintenance objectives.

It can be argued that UI programs are best suited for addressing problems of short term unemployment and that they never were meant to compensate long term unemployment. That may be true, and it may be appropriate to create a separate program (with more definite job search and job training components) to compensate the long term unemployed. Nevertheless, it is clear that the long term unemployed experience very high poverty rates and that UI benefits have a substantial poverty-reducing impact. In the absence of some alternative new program and given the particularly large amount of long term unemployment experienced in the 1980s, it seems clear that UI benefit cutbacks have contributed to economic hardship and to occurrences of poverty in the 1980s. Since UI has not performed that well in meeting its traditional objectives in the 1980s, policymakers should exercise caution in suggesting new uses for UI trust funds. Ensuring that trust funds are built to adequate levels is also important.

Table 1. Total Unemployment and Insured Unemployment, 1968 to 1987

YEAR	Unemployment Rates (Percentages)			Unemployment (thousands)			Insured as a Proportion of Total Unemployment
	Persons 16 and Older (1)	Men 25 and Older (2)	Unemployed 27 Weeks and Over (3)	Persons 16 and Over(TU) (4)	Unemployed 27 Weeks and Over (5)	Insured Unemployment(IU) (6)	(IU/TU) (7)
1968	3.6	1.8	.20	2817	156	1079	.383
1969	3.5	1.7	.16	2832	133	1065	.376
1970	4.9	2.8	.28	4093	235	1762	.430
1971	5.9	3.5	.62	5016	519	2102	.419
1972	5.6	3.1	.65	4882	566	1800	.369
1973	4.9	2.6	.38	4365	343	1578	.362
1974	5.6	3.0	.41	5156	381	2202	.427
1975	8.5	5.5	1.28	7929	1203	3900	.492
1976	7.7	4.8	1.40	7406	1348	2922	.395
1977	7.1	4.2	1.04	6991	1028	2584	.370
1978	6.1	3.4	.63	6202	648	2302	.371
1979	5.8	3.3	.51	6137	535	2372	.387
1980	7.1	4.8	.77	7637	820	3305	.433
1981	7.6	5.1	1.07	8273	1162	2989	.361
1982	9.7	7.5	1.61	10678	1776	3998	.374
1983	9.6	7.7	2.29	10717	2559	3347	.312
1984	7.5	5.7	1.44	8539	1634	2434	.285
1985	7.2	5.3	1.11	8312	1280	2561	.308
1986	7.0	5.3	1.01	8237	1187	2607	.316
1987	6.2[a]	4.8[a]	.88[a]	7452[a]	1050[a]	2297[b]	.305[b]

Source: Based on data published by the U.S. Department of Labor.
a - First eleven months of 1987. b - First nine months of 1987.

Table 2. State Unemployment Insurance Benefits: Absolute Dollar Amount and as a Percentage of GNP, 1968 to 1986

YEAR	State UI Benefits ($ billions)				State UI Benfits as a Percent of GNP[b]			
	Total (1)	Regular State UI[a] (2)	Federal-State Extended Benefits[a] (3)	Temporary Programs[a] (4)	Total (5)	Regular State UI (6)	Federal-State Extended Benefits (7)	Temporary Programs (8)
1968	2.0	2.0	0	0	.23	.23	0	0
1969	2.1	2.1	0	0	.23	.23	0	0
1970	3.8	3.8	0	0	.37	.37	0	0
1971	5.6	4.9	.7	0	.50	.44	.06	0
1972	5.5	4.5	.5	.5	.45	.37	.04	.04
1973	4.2	4.0	.1	0	.32	.30	.01	.00
1974	6.6	6.0	.5	0	.44	.41	.03	.0
1975	16.5	11.9	2.5	2.1	.98	.71	.15	.13
1976	14.3	9.2	2.3	2.8	.78	.50	.13	.15
1977	11.5	8.6	1.7	1.2	.57	.43	.09	.06
1978	8.6	7.9	.6	0	.38	.35	.03	.00
1979	9.1	8.9	.2	0	.36	.35	.01	0
1980	15.3	13.7	1.6	0	.54	.49	.06	0
1981	15.1	13.8	1.3	0	.48	.44	.04	0
1982	24.6	21.0	2.4	1.2	.72	.61	.07	.04
1983	25.6	18.4	1.7	5.5	.70	.52	.05	.15
1984	15.5	13.1	0	2.3	.40	.34	.00	.06
1985	15.4	14.3	0	.8	.37	.35	.00	.02
1986	16.0	16.0	0	0	.37	.37	.00	.00

Source: Based on Table 3.11 of the National Income and Product Accounts.
[a]Data partly on unpublished detail from Table 3.11 of the National Income and Product Accounts. Column (2) includes reimbursable benefits. Column (4) includes payments of Temporary Compensation in 1972-73, Federal Supplemental Benefits in 1975-78 and Federal Supplemental Compensation in 1982-85.
[b]GNP has been adjusted for cyclical variation. Estimates of full employment GNP used in the calculations were obtained from the U.S. Congressional Budget Office.

Table 3. Poverty Status and Unemployment Duration, 1976 and 1983[a]

Unemployment Duration	1976				1983			
	Worker Counts (000's)	POVERTY RATES Pre Transfer	Post Transfer	Change	Workers Counts (000's)	POVERTY RATES Pre Transfer	Post Transfer	Change
			ALL UNEMPLOYED					
1-13	10,943	.171	.121	.050	10,852	.232	.187	.045
14-26	4585	.234	.152	.082	5854	.292	.224	.068
27-39	2135	.341	.182	.159	2804	.419	.297	.122
40-50	1247	.474	.262	.212	1922	.532	.388	.144
51-52	798	.599	.372	.227	1446	.665	.503	.162
TOTAL	19,708	.240	.154	.086	22,879	.323	.247	.076
			RECIPIENTS OF UI					
1-13	2441	.089	.045	.044	2914	.111	.065	.046
14-26	1825	.174	.068	.106	2378	.205	.107	.098
27-39	925	.326	.104	.222	1185	.359	.174	.185
40-50	473	.463	.110	.353	662	.517	.272	.245
51-52	296	.591	.203	.388	445	.620	.387	.233
TOTAL	5960	.207	.075	.132	7584	.244	.132	.112
			NONRECIPIENTS OF UI					
1-13	8502	.194	.143	.051	7938	.277	.232	.045
14-26	2760	.274	.207	.067	3476	.352	.305	.047
27-39	1210	.351	.241	.110	1619	.436	.387	.076
40-50	774	.481	.355	.126	1260	.540	.448	.092
51-52	502	.604	.472	.132	1001	.684	.555	.129
TOTAL	13,748	.255	.188	.067	15,295	.362	.304	.058

[a]Source: Based on tabulations of the Current Population Survey conducted at the Urban Institute.

Table 4. Changes in the Ratio of Insured Unemployment to Total Unemployment in Selected States, 1985-86 Versus 1978-79

	Ratio of Insured Unemployment to Total Unemployment			Total Unemployment Rate (Percent)		
	1978-79 (1)	1985-86 (2)	Change (3)	1978-79 (4)	1985-86 (5)	Change (6)
Four States with the Largest UI Debts						
Illinois	.464	.297	-.167	5.8	8.6	2.8
Michigan	.464	.260	-.204	7.4	9.4	2.0
Ohio	.358	.272	-.086	5.6	8.5	2.9
Pennsylvania	.501	.412	-.089	6.9	7.4	.5
Simple Average of Four States	.447	.310	-.137	6.4	8.5	2.1
Four States With Large UI Trust Funds						
California	.408	.428	.022	6.6	7.0	.5
Florida	.226	.180	-.046	6.3	5.8	- .5
Massachusetts	.462	.544	.082	5.8	3.8	-2.0
New York	.436	.370	-.066	7.4	6.4	-1.0
Simple Average of Four States	.383	.380	-.003	6.5	5.8	- .7
U.S. Total	.379	.312	-.067	6.0	7.1	1.1

Source: All data from the U.S. Department of Labor.

Table 5. Unemployment Rates by Region and Period, 1967-1986

CENSUS REGION AND DIVISION	Average Unemployment Rate			Change in Unemployment Rate		Average Unemployment Ratios	
	1967 TO 1969	1970 TO 1979	1980 TO 1986	1967-69 TO 1970-79	1970-79 TO 1980-86	1970-79 TO 1967-69	1980-86 TO 1970-79
NORTH EAST	3.30	6.95	7.26	3.65	0.31	2.106	1.044
N ENG	2.93	6.93	5.71	4.00	-1.22	2.363	0.825
M ATL	3.40	6.97	7.81	3.57	0.84	2.050	1.121
MIDWEST	3.07	5.55	8.91	2.48	3.36	1.810	1.606
ENC	3.30	6.08	9.93	2.78	3.85	1.842	1.633
WNC	2.47	4.23	6.53	1.76	2.30	1.715	1.543
SOUTH	3.73	5.54	7.66	1.81	2.12	1.484	1.382
S ATL	3.60	5.64	6.97	2.04	1.33	1.567	1.236
ESC	4.03	5.69	9.96	1.66	4.27	1.411	1.750
WSC	3.70	5.23	7.47	1.53	2.24	1.414	1.428
WEST	5.10	7.37	7.96	2.27	0.59	1.445	1.080
MTN	4.50	5.96	7.20	1.46	1.24	1.324	1.208
PAC	5.30	7.84	8.21	2.54	0.37	1.479	1.048
TOTAL U.S.	3.63	6.21	7.96	2.58	1.75	1.709	1.281

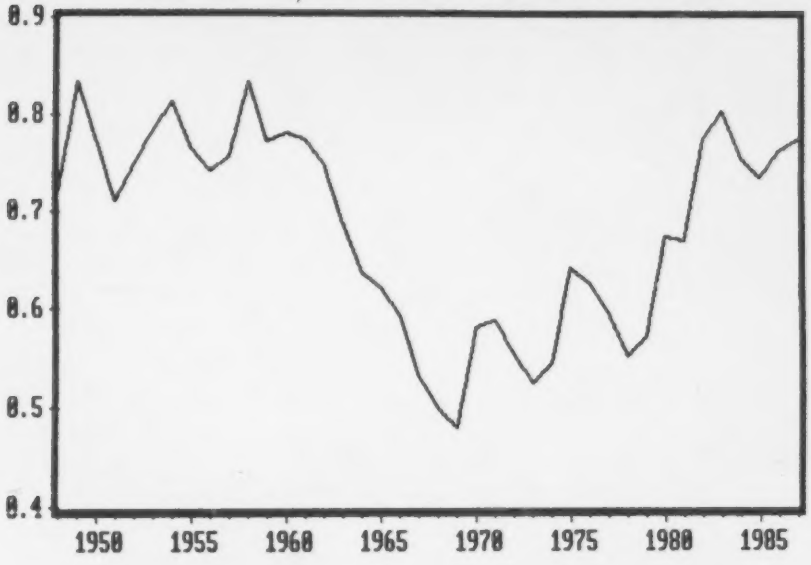
Source: All data from the U.S. Department of Labor

Table 6. Average IU/TU Ratios by Region and Period

CENSUS REGION AND DIVISION	Average IU/TU Ratio			Ratio of IU/TU Ratios	
	1968-1969	1978-1979	1985-1986	1978-79 TO 1968-69	1985-86 TO 1978-79
NORTH EAST	0.572	0.467	0.408	0.816	0.874
N ENG	0.612	0.463	0.457	0.757	0.987
M ATL	0.560	0.468	0.396	0.836	0.846
MIDWEST	0.338	0.408	0.291	1.207	0.713
ENC	0.324	0.408	0.281	1.259	0.689
WNC	0384	0.410	0.324	1.068	0.790
SOUTH	0.250	0.288	0.240	1.152	0.833
S ATL	0.240	0.275	0.242	1.146	0.880
ESC	0.314	0.368	0.242	1.172	0.658
WSC	0.226	0.252	0.234	1.115	0.929
WEST	0.408	0.384	0.382	0.941	0.995
MTN	0.276	0.298	0.279	1.080	0.936
PAC	0.439	0.406	0.418	0.925	1.030
TOTAL U.S.	0.380	0.379	0.312	0.997	0.823

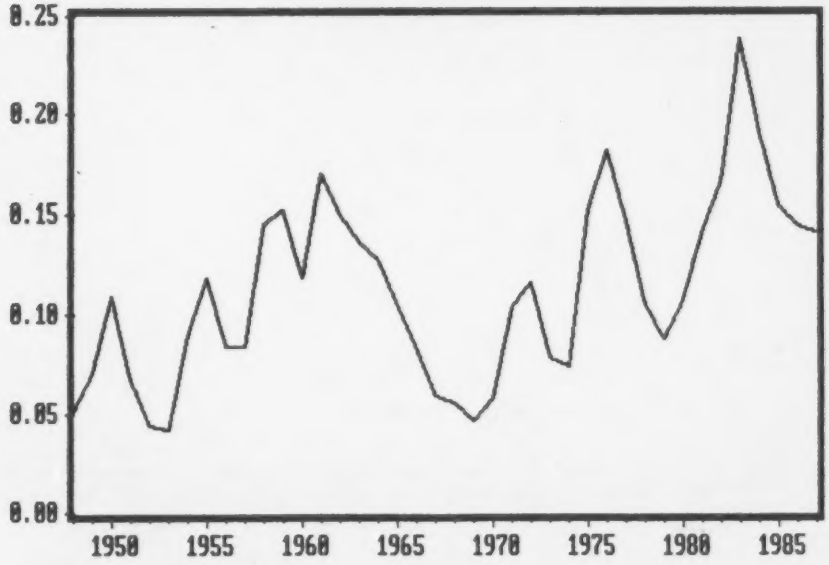
Source: All data from the U.S. Department of Labor

Figure 1. Unemployment Rate For Men 25 and Older as a Proportion of the Rate for All Persons, 1948-1987



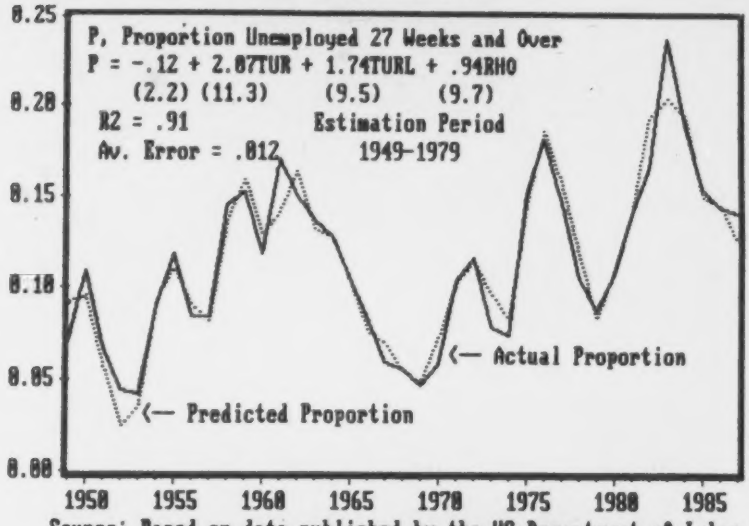
Source: Unemployment data from the US Department of Labor

Figure 2. Proportion of Unemployment Lasting 27 Weeks and Over, 1948-1987



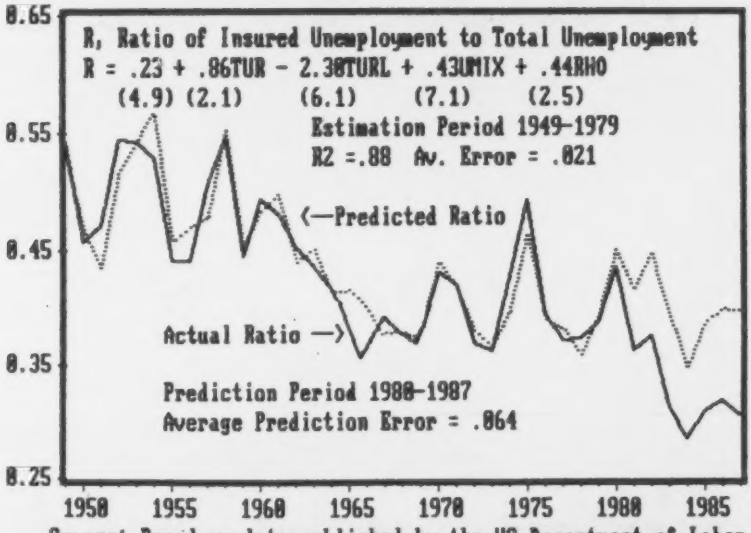
Source: US Department of Labor

Figure 3. Actual and Predicted Proportions Unemployed 27 Weeks and Over, 1949-1987



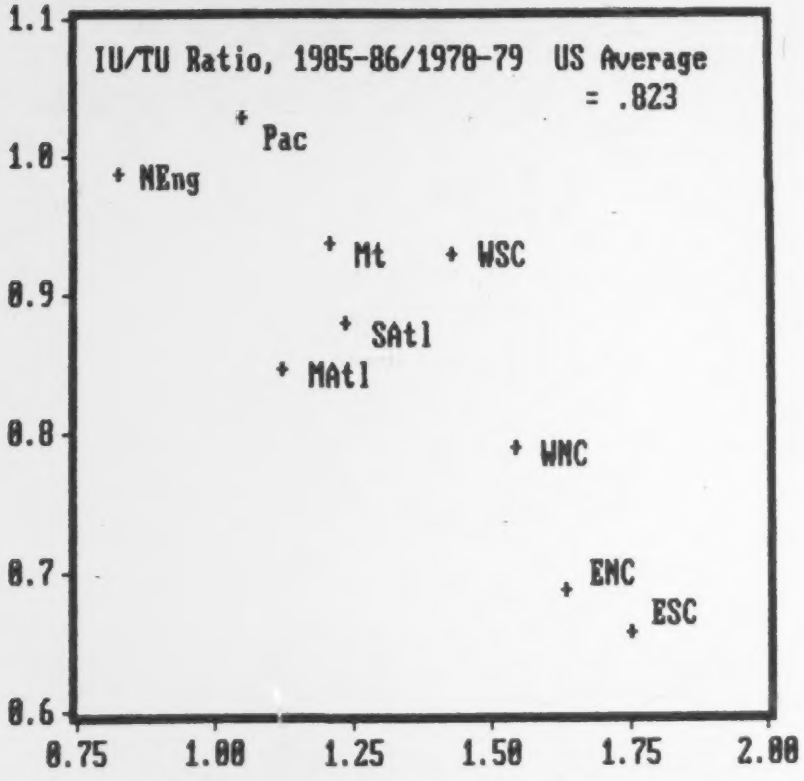
Source: Based on data published by the US Department of Labor
Explanatory variables: TUR = Unemployment rate for persons 16+, TURL = TUR lagged, RHO = Serial correlation correction

Figure 4. Actual and Predicted Ratios of Insured Unemployment to Total Unemployment, 1949-1987



Source: Based on data published by the US Department of Labor
Explanatory variables: TUR, TURL = Current and lagged U rates, UMIX = Ratio of U rate for men 25+ to the TUR, RHO = Ser. corr.

Figure 5. Ratios of IU/TU Ratios by Census Division, 1985-86/1978-79



Mr. PEASE. All right. Thank you very much, Mr. Vroman.
Next, Mr. Nicholson.

STATEMENT OF WALTER NICHOLSON, PROFESSOR OF ECONOMICS, AMHERST COLLEGE, AND SENIOR FELLOW, MATHEMATICA POLICY RESEARCH

Mr. NICHOLSON. Thank you, Mr. Chairman. My colleague, Walter Corson, and I are very happy to be here today to have a chance to talk with you about some of the lessons we've learned from examining extended unemployment compensation programs over the past 15 years. We have a fairly long prepared statement, which we've left, and I'll spare you the joy of hearing it. Instead, I'll try to be very brief, and just summarize some of the high points of it.

Experiences under the extended benefits programs in effect during the 1970s and 1980s strongly support some Federal involvement in the provision of such benefits during recessions. They also support the notion that the potential duration of benefits available under such extensions should in some way be tailored to market conditions, if the programs are to provide a relatively constant degree of insurance protection over the business cycle.

But, our review of these experiences suggest a number of cautions in the design of extended benefits programs, if they are to achieve their intended goals. Let me briefly summarize some of the lessons we think we've learned.

First lesson, choice of a particular labor market indicator as a triggering device can have very important effects on program performance. The most important illustration of this point is, of course, the EB program, where reliance on the IUR as a triggering device resulted in a marked reduction in the size of the program as the IUR fell relative to the total unemployment rate in the 1980s.

This problem was exacerbated by the concomitant changes in the EB trigger formula, which required higher IURs for the program to come into effect. Hence, some care must be taken to assure the trigger indicators are updated to accurately portray true labor market conditions. Some care must also be taken to insure that they are not unduly influenced by the peculiar nature of certain individual States' UI laws.

The second lesson I think we've learned: Fine tuning of extended benefits duration to labor market conditions and to changes in those conditions is administratively difficult and may be ineffective in directing benefits to areas of high unemployment. The experience with FSB, for example, indicates that one can go too far in fine tuning durations.

That program adjusted durations in 2-week increments that could change quite frequently within a State. Yet, our analysis found that larger increments and fewer levels would have been both more effect in terms of directing benefits and far easier to administer.

Lesson 3. Implementation of additional eligibility provisions for extended benefits may be administratively complex and may have relatively little effect on caseload size and composition. All the recent extended benefits programs, EB, FSB, FSC, at times contained uniform, more stringent eligibility provisions than do many

States regular UI programs. Our research on these provisions show that the quantitative effect of them on the caseload was relatively small.

Some States also experienced severe administrative problems in implementing the provisions, especially those under the FSC program. We found little evidence that the eligibility provisions achieved their intended purposes to any extent. Hence, we believe, that use of additional eligibility provisions for extended benefits programs may not be a very cost-effective strategy to pursue.

Lesson 4. Lags in the implementation and termination of extended benefits programs can result in their being inappropriately targeted on strong labor markets. Both the FSB program in the 1970s and the FSC program in the 1980s were implemented relatively late in the recession they were intended to address, and both continued to pay benefits into periods of relatively healthy labor markets.

There are, therefore, strong reasons to rely more on permanent "automatic" programs as a first line of defense during recessions.

Lesson 5. Integration of permanent and emergency extended benefits programs can be very difficult. Perhaps the most chaotic example is provided by experiences with FSC and EB during the later phases of the 1982–83 recession. States had major difficulties in paying benefits under EB and FSC during this period, and those difficulties were compounded by the frequent changes in the characteristics of the FSC program itself.

Future extended benefits policies should therefore be structured so the tiers of emergency benefits can be put into place in an administratively simple way.

Now, given this background of what I think we've learned from the prior experiences, let me just say a few words about H.R. 2676.

In general, the EB portions of 2676, which are the only ones I'll speak about, can be regarded as an attempt to adjust the EB trigger formula for secular changes in the IUR, together with building in a schedule of emergency extensions that come into effect as labor market conditions worsen. In this respect, the bill is quite consistent with our views of the lessons that have been learned from the past two decades' experiences with extended benefits programs.

Our principal caveats about the bill in its current form can best be raised in a series of questions that we believe should be considered before the bill is finally passed.

Question 1. Is the system proposed under the bill too complex to administer? Are there too many levels of potential duration and associated trigger rates? Might a simpler schedule of durations and trigger rates accomplish the same purposes as the bill intends?

Question 2. How will the 105 and 130 percent provisions in the bill actually operate in practice? Will these provisions perform better than the 120 percent rule has? The history of the 120 percent rule is that it has been waived off and on so many times that I've lost count. Will the 105 and 130 percent rules fare better?

Question 3. Is the reduction in the minimum trigger rate to 4 percent appropriate, given historical changes in the IUR which have occurred? The move to 4 percent in the EB law does represent a significant reduction from the current 5 or 6 percent trigger rate.

But, it still may not be sufficient to restore EB to the relative position it occupied in the 1970s, if that were the goal.

Question 4. Will the new trigger provisions impact differentially on the States, depending on the nature of the recent experiences of their UI programs? The secular decline in the IUR has not been uniform across States, and changing reliance on the IUR may make quite a difference in how it operates in different States.

Question 5. How will the alternative trigger procedures, which are based on the total unemployment rate published by BLS actually operate? The BLS data are subject to relatively large errors, and a major reliance on them for trigger purposes, may introduce considerable volatility into the EB program.

I should repeat that these questions are only about how H.R. 2676 will operate in practice. They do not reflect a general dissatisfaction on our part with the overall intent of the bill. We believe it is important to recognize that this is a very complex bill. Consequently, some detailed research may be necessary to determine whether it succeeds in reaching its goals in the way it is currently written.

Thank you very much for letting us present our views on this bill.

[The prepared statement follows:]

STATEMENT ON EXTENDED BENEFITS PROGRAMS FOR THE SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES DECEMBER 14, 1987

Walter Corson
Mathematica Policy Research, Inc.

and

Walter Nicholson
Amherst College and
Mathematica Policy Research, Inc.

Mr. Chairman and members of the Committee, my colleague, Walter Corson, and I are pleased to have this opportunity to discuss with you some of the results of our studies of extended unemployment insurance (UI) benefits. During the past twelve years we have examined the performance of a number of Federal programs that were intended to provide additional UI benefits to unemployed workers who had exhausted their entitlements under the regular state-federal UI program. Federal policy in this area has undergone a number of significant changes during the period we have been examining these programs. The "permanent" extended benefits (EB) program, first implemented in 1971, was significantly reduced in size in the early 1980s. In addition, the emergency extended benefits introduced as part of the Federal Supplemental Compensation (FSC) program during the recession of the early 1980s were quite different from those incorporated in the Federal Supplemental Benefits (FSB) program a decade earlier. As a result of these changes, the current Federal posture with respect to extended benefits policy is both cumbersome and ill-defined. In our prepared testimony we seek to develop a framework for judging extended benefits policy and to use that framework in conjunction with our prior research results to illustrate some of the policy issues that must be faced if we are to have a coherent policy.

A. UNEMPLOYMENT INSURANCE DURING RECESSIONS

Unemployment Insurance is a program intended to provide monetary assistance to eligible individuals who have lost their jobs through no fault of their own. Viewed as insurance, the program provides limited protection against income losses that result from workers being laid off. Although there are a variety of private market mechanisms that provide some protection of this type to workers (for example, privately negotiated supplemental unemployment benefits, severance pay provisions, and some compensating wage differentials are found in many markets), for the most part the program has been regarded as a government responsibility. Such public insurance provision provides a broad sharing of unemployment risks and offers some economies in the enforcement of eligibility requirements.

Currently all states (and several other jurisdictions) operate approved unemployment insurance programs. Although the details of these programs differ significantly from state-to state, all states provide benefits on the basis of past wages received and all finance these benefits through payroll taxes that are (to some extent) based on the employer's prior unemployment experiences. These major aspects of the program support the view that the program should be primarily regarded as insurance against wage loss. A few specific provisions of states' programs (such as limits on the maximum weekly benefit payable and the availability of "dependents' allowances" in some states) suggest that the programs are regarded as intended to meet some redistributional goals as well.

All states currently specify a maximum duration under their programs of, generally, 26 weeks of benefits.[1] Although the provision of such a limited duration of benefits has been a feature of the UI program since its inception, there is no agreement about the specific rationale for this feature (Corson and Nicholson, 1982, pages 9-13). In general, placing a limit on the duration of UI benefits under state programs appears to represent a compromise between the desire to provide protection to claimants while they are unemployed and concerns about potential implications of unlimited programs in terms of program cost and effects on the willingness of workers to accept employment.[2]

On a conceptual level it seems clear that the potential duration for which individuals are able to collect UI benefits should be lengthened during recessionary periods. As economic activity turns down unemployment increases and unemployment spells lengthen. Hence, claimants' needs for insurance protection increase. Only through increases in the potential duration of benefits can the programs continue to provide the same relative amount of protection that they offer during more normal periods. Of course, the extent of such expansions is subject to substantial policy debate and there is no agreed-upon standard. Our study of recessionary experiences during the 1970s (Corson and Nicholson, 1982, page 6) suggested that extending durations by approximately 3-5 weeks for each percentage point increase in the insured unemployment rate (IUR) above 5 percent would maintain the degree of insurance protection that UI customarily provides. But these calculations are subject to considerable errors and use a standard of adequacy (maintenance of the overall exhaustion rate for all UI benefits at a nonrecessionary level) that is subject to some disagreement. Nevertheless, the principle that benefits should be extended during recessions and that the extent of those extensions should bear some relationship to the level of labor market activity seems to be well-established.

B. REVIEW OF EXTENDED BENEFIT POLICY

Although some states have at times adopted extended UI benefits programs during recessions, for the most part such extensions have come about through Federal initiatives. This locus of policy development is consistent with the view that recessions are national in origin and that it is therefore the Federal government's responsibility to do something about the costs they impose. However, such Federal responsibility has related only to matters of the funding and timing of the policies together with some provisions that affect their overall size. Most important eligibility and benefit entitlement provisions of the extensions have incorporated the respective state regular UI regulations in these areas. Hence, although extended benefit policy has exhibited some nationwide consistency because of the Federal government's involvement in implementation and financing, in actual operation the extended benefits programs have incorporated the same wide range of state-to- state variation in key program parameters as found in the regular UI program.

1. The "Permanent" Extended Benefits Program (EB)

Prior to 1970, Federal extended benefits programs were adopted on a more-or-less ad hoc basis primarily in response to recessionary circumstances. Because implementing these programs often involved lengthy political debate they were not always developed in an efficient and timely manner.[3] Recognizing the need for a more consistent approach to extended

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[1] A few states offer longer than 26 weeks and most states tie an individual's potential duration to the extent of his or her base period employment.

[2] For a discussion of the evidence regarding disincentive effects of changing UI duration see Moffitt (1985).

[3] The largest of these early programs was the temporary Extended Unemployment Compensation program of 1961. For a summary of these early program experiences see Corson and Nicholson (1982).

benefits policy during recessions, Congress passed the Extended Unemployment Compensation Act of 1970. Under the Act extended benefits (EB) became payable anytime a state's insured unemployment rate (IUR) exceeded 4 percent for a consecutive 13 week period and was at least 120 percent of the average IUR for the corresponding 13 week period in the prior two years.[1] Originally the EB program also incorporated a "national trigger" under which extended benefits were payable in all states when the seasonally adjusted national IUR exceeded 4.5 percent (reduced to 4 percent during the 1974-75 recession). Whenever the EB program is triggered on under these criteria all claimants who have exhausted their regular UI entitlements and who have not completed their benefit years are entitled for up to 13 additional weeks of benefits (or one-half their original UI entitlement, if that is less) up to a maximum of 39 total weeks of benefits.

Throughout the 1970s the EB program provided a first line of defense for UI exhaustees during periods of slack labor market activity. However, several actions taken in the early 1980s had the effect of scaling back the program substantially. Most important, the Omnibus Budget Reconciliation Act of 1981 instituted several changes in the EB triggering formulas that made it much more difficult for states to become eligible for and to remain on EB. These changes included (1) elimination of the national trigger; (2) elimination of EB claimants from the calculation of the EB trigger rate thereby mitigating situations where having the EB program in effect contributed to the program's continuing; and (3) raising the state EB trigger rate from 4 to 5 percent (or to 6 percent if the 120 percent criterion is to be waived). A general goal of all of these changes in EB triggering was to focus availability of extended benefits on areas and time periods when labor markets were weakest and to avoid paying such benefits in strong labor markets.

When combined with somewhat more stringent eligibility standards for EB that were also adopted in the early 1980s, the triggering changes incorporated in the OMBRA of 1981 had the effect of reducing the size of the program substantially relative to what it had been during earlier recessions. Our detailed examination of the EB policy changes (Corson and Nicholson, 1985) estimates that EB first payments were reduced by about 24 percent during the 1982-83 recession below what they would have been had the program remained unchanged.

The EB program was reduced in size even further during the 1980s by the secular decline in the relationship between the insured and total unemployment rates.[2] Although there remains considerable uncertainty about the causes of this decline, its impact on the EB program caseload resulted both from the fact that states had even more difficulty meeting the tougher trigger standards required under the 1981 changes (because their IURs were inexplicably lower) and because the lower levels of insured unemployment directly reflected a smaller potential caseload for EB. As we discuss in our analysis of policy options, these experiences suggest that there is a clear need to revise the EB triggering mechanism (perhaps by returning to the lower trigger rates that prevailed before 1981) to reflect the changing relationship between insured and total unemployment.

2. Emergency Extended Benefits Programs Since 1970

Adoption of the permanent EB program in 1970 did not completely supplant policy interest in developing emergency extended benefits programs in response to recession circumstances. Indeed, even with EB, Congress has adopted such programs in every major recession since the early 1970s. Experiences in the implementation and operations of each of these emergency extensions offer lessons both for the future design of emergency programs and for the integration of those programs into a coordinated overall UI policy.

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[1] This 120 percent requirement was altered and completely waived at various times during the 1970s.

[2] For a discussion of this changing relationship see Burtless (1983).

The first emergency extension following adoption of the permanent EB program came in connection with the relatively modest business downturn that occurred in 1970-71. This emergency program (which expired in March, 1973) offered 13 additional weeks of benefits to claimants in states with high unemployment rates. Because the trigger rate used for this program differed from that used under EB, experiences under the program were characterized by the administratively confusing situation that a state could be eligible for either, both, or none of the extended benefits programs available at the time. As we will see below, such a situation also characterized the FSC program in the 1980s.

A much larger emergency program, the Federal Supplemental Benefits (FSB) program was adopted in 1974 to address the sharply higher unemployment rates associated with the 1974-75 recession. When fully implemented the FSB program provided an additional 26 weeks of benefits beyond EB (up to a total of 65 weeks under regular UI, EB, and FSB). In all FSB paid more than $6 billion in benefits to more than 5 million claimants. The FSB program has been extensively analyzed by us and by other authors. One conclusion that emerges from these studies is that FSB may have been a bit too generous given the labor market conditions that prevailed during most of its operation. Total exhaustion rates under all UI programs were much lower when FSB was in effect than during non-recessionary periods implying that UI protection had actually increased during the recession. Similarly, administrators of FSB faced a number of situations in which it appeared that the program's benefits were not being targeted only on those who needed them because of their long term unemployment. These kinds of dissatisfaction with FSB provided one important factor that undoubtedly motivated some of the cutbacks in EB undertaken in the early 1980s.

Rising unemployment rates associated with the 1982-83 recession once again prompted the adoption of emergency legislation--in this case the Federal Supplemental Compensation (FSC) program which was first enacted in August, 1982. Because both the economic and policy environments were quite complex during the time period FSC was in effect (the 1982-83 recession, as measured by the unemployment rate, was the most severe in the postwar period and it occurred soon after the major cutbacks in EB had been enacted), the final form of the FSC program mirrored those complexities. The initial temporary FSC program was itself extended three times over a nearly four year period. Benefit duration varied both by state and by time period in this constantly changing program (see Corson, Grossman, and Nicholson, 1986 for a description of these changing program features). In general, these changes were intended to focus FSC benefits on states which were experiencing the most severe labor market problems and which, because of the 1980-81 cutbacks, might have been ineligible for EB. But the targeting mechanisms used were ineffective. They did not appear to direct benefits more effectively toward areas and time periods that exhibited high unemployment than did the regular UI program, primarily because a minimum level of FSC benefits was paid in all states, regardless of the unemployment rate. Moreover, a substantial fraction of benefits was paid after the recession was over. Hence, although the program ultimately paid more that $9 billion in benefits during the 1982-83 recession and beyond those benefits could have been better focused if they were to achieve the goal of providing unemployment insurance assistance to workers who most needed them.

C. LESSONS FROM THE RECESSIONS OF THE 1970s AND 1980s

This brief review of experiences under the extended benefits programs that were in effect during the 1970s and 1980s offers strong support for some Federal involvement in the provision of such benefits during recessionary periods. They also support the notion that the potential duration of benefits available under such extensions should in some way be tailored to labor market conditions if the programs are to provide a relatively constant degree of unemployment insurance protection over the business cycle. But our review of these experiences suggests a number of cautions in the design of such programs if they are to achieve their intended goals. Our conclusions from examining these programs in some detail can be summarized in five specific "lessons" that might act as a guide for future legislation in this important area.

1. Choice of a Particular Indicator of Labor Market Strength As A Triggering Device Can Have an Important Effect on Program Performance

The most important illustration of this point is, of course, the EB program where reliance on the IUR as a triggering device resulted in a marked reduction in the size of the program as the IUR fell relative to the TUR during the 1980s. The problem was exacerbated by concommitant changes in the EB trigger formula which required higher IURs for program implementation. In general, it seems likely that a trigger indicator for any future extended benefits program will be based on UI claims data, since these data are available in a timely enough manner for program use. But some care must be taken to insure that these data accurately portray true labor market conditions and that they are not unduly influenced by the peculiarities of individual states' UI laws. Attempts to implement extended benefits programs on a substate level could encounter even more severe problems in developing a suitable trigger and the development of an effective program may be infeasible given current data availability.

2. Fine Tuning of Extended Benefit Duration to Labor Market Conditions and Changes in Those Conditions Is Administratively Difficult and May Be Ineffective in Directing Benefits to High Unemployment Areas

The rationale for extending benefits suggests that the duration of these benefits should be adjusted for labor market conditions with longer extensions available the worse conditions are. However, the experience of the FSC program indicates that one can go too far in attempting to fine tune duration. That program adjusted duration in two-week increments that could change frequently within a state, yet our analysis found that this degree of sensitivity to labor market conditions was administratively complex and ineffective on directing benefits to states and time periods where labor markets were weakest. Larger increments and fewer levels would have been more effective.

3. Implementation of Additional Eligibility Provisions for Extended Benefits Programs May be Administratively Complex and May Have Relatively Little Effect on Caseload Size

The EB, FSB, and FSC programs have, at times, contained uniform, more stringent eligibility provisions than do many states' regular UI programs. The intent of these provisions was to assure some similarity in the treatment of extended benefits claimants across the states, and, possibly, to target benefits to those workers with the strongest attachment to the labor force. Our research showed that the quantitative effect of these provisions on the caseload was relatively small. Some states also experienced administrative problems in implementing the provisions, especially under the FSC program. We found little evidence that the eligibility provisions achieved their intended purposes to any significant extent. Hence, we believe the use of additional eligibility provisions for extended benefits programs may not be very cost-effective.

In some of our research we have examined the possibility of adopting some form of a means test for extended benefits programs and this option was explored by the National Commissions on Unemployment Compensation.[1] Such an option would achieve some anti-poverty effectiveness, but would run counter to the insurance-based rationale for UI. Means testing of extended benefits has never been implemented as an active policy in the United States although this policy option is used in several European countries.

4. Lags in the Implementation and Termination of Emergency Programs Can Result in Their Being Inappropriately Targeted on Strong Labor Markets

Both the FSB and FSC programs were implemented relatively late in the recession they were intended to address and both continued to pay

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[1] See the discussion in National Commission on Unemployment Compensation (1980).

benefits into periods of relatively healthy labor markets. Hence, both the UI protection and the macroeconomic stimulus provided by these programs were not as significant as might have been expected. Uncertainties in the policy development and implementation process may insure that these lags will be a constant problem with emergency legislation during recessions. There are therefore strong reasons to rely on more "permanent", automatic programs as a first line of defense during recessions. Our research on the EB program suggested that it performed quite well during the 1974-75 recession. Shortcomings of the (significantly abridged) EB program during the 1982-83 recession should not obscure the fundamental desirability of having such an automatic program available.

5. Integration of Permanent and Emergency Extended Benefits Programs Can Be Difficult

Integration of emergency programs with the permanent EB program has been particularly problematic when the structure of the emergency program is complex and when it uses different triggering criteria than does EB. Perhaps the most chaotic example is provided by experiences with FSC and EB during the latter phases of the 1982-83 recession. In part this situation seems to have been created by a perceived need to design FSC so as to fill some of the "holes" left in extended benefits coverage by cutbacks in the EB program in the early 1980s. Whatever the cause, states had major difficulties in paying benefits under EB and FSC during this period and those difficulties were compounded by the frequent changes in the characteristics of the FSC program itself. Future extended benefits policy should therefore be structured so that tiers of emergency benefits can be put into place in an administratively simple way as needed.

D. A BRIEF ANALYSIS OF H.R. 2676

H.R. 2676 (the "Pease Bill") was filed on June 11, 1987. This bill is intended to "provide an improved program of extended unemployment compensation..." primarily through revisions to be made in the EB program. Although we have not had sufficient time to evaluate fully all of the many provisions of the this bill, it may be useful here to offer a few opinions based on our experiences with prior programs.

The Pease Bill incorporates seven principal changes into the EB Program:

- o Adoption of a flexible maximum duration based on each state's IUR (as defined in the Bill)
- o Reduction in the IUR trigger necessary for payment of any EB benefits to 4 percent (from the current 5 percent/6 percent requirement)
- o Amendment of the 120 percent rule to be only 105 percent of the previous six years' IUR, except for the lowest tier of benefits which requires an IUR of 130 percent of the prior 6 years' average
- o Adoption of a seasonal adjustment procedure for IURs in determining eligibility for EB
- o Provision for use of the total unemployment rate for an EB trigger in certain circumstances
- o Funding for EB based on the IUR--the higher the IUR (and the longer are EB potential durations) the greater is the Federal contribution
- o Encouragement of EB demonstration projects based on substate measures of labor market strength

The Pease Bill can be regarded as an attempt to adjust the EB trigger formula for secular changes in the IUR together with building in a

schedule of emergency extensions that come into effect as labor market conditions worsen. In this respect the Bill is quite consistent with our review of the lessons that have been learned from the past two decades' experiences with extended benefits programs. Adoption of a seasonally adjusted trigger, adjustment of the 120 percent rule and experimentation with substate extensions also seem to be policies that might be recommended on the basis of prior experiences. Overall then we are supportive of the Bill.

Our principal caveats about the Pease Bill in its current form can best be raised in the form of a few questions which we believe should be considered before passage:

1. Is the system proposed under the Bill too complex to administer? Are there too many levels of potential duration and associated trigger rates? Experiences under FSC are not sanguine about the ability of the UI system to cope with a constantly changing program structure. Might a simpler schedule of durations and trigger rates accomplish the same purposes?

2. How will the 105 and 130 percent provisions in the Bill actually operate in practice? Will they achieve the goal of identifying states that are entering recessionary periods with out imposing unrealistically high threshold levels for eligibility? Will these provisions perform better than the 120 percent rule has?

3. Is the reduction of the minimum trigger rate to 4 percent appropriate given the historical changes in the IUR that have occurred? The move to 4 percent does represent a significant reduction from the current 5/6 percent trigger, but it may not be sufficient to restore EB to the relative position it occupied in the 1970s.

4. Will the new trigger provisions impact differentially on the states depending on the nature of recent experiences in their UI programs? The secular decline in the IUR has not been uniform across the states. Although there is as yet no agreement about either the causes of the decline nor why it differs across the states, such state-to- state differences might cause substantial differences in the actual performance of the revised EB program.

5. How will the alternative trigger procedures (which are based on the total unemployment rate published by BLS) actually operate? If these will be operative on many occasions they probably deserve intensive empirical study since they have not been used for EB triggering in the past. Since the data are subject to relatively large errors a major reliance on them for trigger purposes may introduce considerable volatility into the EB program.

We should repeat that these are only questions about how the Pease Bill might operate in practice--they do not reflect a dissatisfaction on our part with the overall intent of the Bill. But we believe that it is important to recognize that the Bill is a very complex one. Consequently some detailed research may be necessary to determine whether it succeeds in reaching its intended goals.

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Mr. PEASE. Thank you very much, Mr. Nicholson.
Mr. Bendick.

STATEMENT OF MARC BENDICK, JR., ECONOMIST, BENDICK & EGAN ECONOMIC CONSULTANTS, INC.

Mr. BENDICK. Mr. Chairman, my subject is alternative uses of unemployment compensation and, particularly, their proposed use for self-employment allowances to encourage entrepreneurship among the unemployed.

As economists, my colleague Mary Lou Egan, and I have done research on programs in Britain and France which have provided these allowances to more than half a million of their citizens. These efforts already offer empirical evidence on a much more substantial scale than would be generated by the demonstration projects proposed in the legislation which is now before you.

The bottom line of that experience is that self-employment allowances would have either negligible effects or negative effects on the unemployed, on American business development, and on the unemployment compensation system.

The most basic fact which leads to this conclusion is the extremely modest level of benefits which the proposed allowances would provide. We estimate that the average claimant electing a self-employment allowance would receive about $141 a week for about 7 weeks, a grand total of $1,043. That modest sum is simply not a major inducement to entrepreneurship.

The probability that a new small business will survive beyond its first 2 years is only about 50/50. But, tens of thousands of dollars or more must be laid out in business startup costs. Often, those startup funds come from the entrepreneurs mortgaging his or her home or investing his or her life savings. So, it's not surprising that most unemployed persons cannot be easily swayed by an allowance which antes up only a small fraction of what they themselves must put at risk. Based on British and French experience, no more than one-half of 1 percent of the unemployed would even accept this sort of challenge.

Furthermore, among those who would accept the allowances and whose businesses would then go into business and survive, disproportionate numbers come from the ranks of the better educated, more experienced, better credentialed workers, precisely the jobseekers who have the best chance of leaving the unemployment rolls rapidly without this special program. Self-employment generally requires all the skills and credentials which regular employment requires, and then business management skills as well. It does not easily create additional employment, opportunities for persons at the margin of the labor market, stuck in long-term unemployment or lacking education and readily marketable skills.

In consequence, it is unlikely to reduce significantly the amounts of unemployment payments which the UC system must support.

We also believe that self-employment allowances are an awkward and inappropriate means for the Federal Government to use in efforts to promote employment growth in the United States. Certainly, it is necessary for the Nation to have a dynamic business sector constantly creating more jobs to replace jobs which are lost.

But small businesses are only one source of job growth. Among small businesses, newly-founded business are a particularly poor generator of jobs. And businesses started when the economy is in a recession and unemployment is rising are a particularly poor risk.

Business assistance programs targeted on existing firms—those which have already survived the high mortality startup phase—and which provide long-term assistance on a substantial scale can be very useful in promoting business growth and generating new jobs. The one-time grant of $1,043, provided by the proposed self-employment allowances is the wrong amount of aid, provided in the wrong form, at the wrong time, to the wrong firms.

In short, Mr. Chairman, we conclude that it would be inappropriate to incorporate self-employment allowances into the compensation system supported by the UC trust fund. If the proposed allowances would eventually reduce UC payments by more than allowance outlays, then such inclusion might be appropriate and efficient. But nothing in more than half a dozen years of British and French experience suggest that self-employment allowances in the United States are likely even to approach that standard of effectiveness.

Thank you.

[The prepared statement follows:]

STATEMENT OF MARC BENDICK, JR.

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to participate in these hearings on Reform of the Unemployment Compensation (UC) program. We are Dr. Marc Bendick, Jr., an economist, and Dr. Mary Lou Egan, a specialist in business development. We have been invited here today to discuss proposals to provide "self-employment allowances" under UC. Such allowances would provide financial support to unemployed persons claiming UC who seek reemployment through starting their own businesses. These proposals are currently embodied in HR 3545, the Budget Reconciliation Act of 1987, Section 9242, entitled "Demonstration Program to Provide Self-Employment Allowances for Eligible Individuals," as well as in Title III of HR 2676, "The Extended Unemployment Insurance Reform Act of 1987."

Based on research we have conducted on the operation of similar programs in Great Britain and in France,[1] as well as what is known about the process of business development in the United States, we suggest to this Committee that such allowances would be of questionable utility.[2] Our testimony today explains this unfavorable conclusion in terms of negative impacts of self-employment allowances on UC claimants, American business and economic development, and the UC system itself.

What are Self-Employment Allowances?

Under current law, one condition which an unemployed individual must meet to receive UC benefits is that s/he is "available for work." If that person begins to develop his or her own new small business, then s/he is no longer available to

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[1]The Enterprise Allowance Scheme, operating in Great Britain and Northern Ireland since 1982, has enrolled more than 139,000 participants. The Chomeurs Createurs (Unemployed Entrepreneurs) program, operating in France since 1979, has served more than 235,000. Our research on these programs is documented in Marc Bendick, Jr., and Mary Lou Egan, "Transfer Payment Diversion for Small Business Development: British and French Experience." Industrial and Labor Relations Review 40 (July 1987), pp. 528-542. That research was supported in part by a grant from the Ford Foundation, although we alone are responsible for all findings and conclusions.

[2]This testimony discusses whether self-employment allowances would be a good national program, rather than the narrower issue of whether the small demonstration program called for in the legislation should be carried out.

accept a job offered by someone else, and, in principle,[3] weekly UC payments cease. The proposed self-employment allowances would consist of weekly payments, in the same amount and paid in the same manner as regular (and extended) UC payments, which would continue in parallel with earnings the claimant would generate from the new enterprise. This supplemental income would reduce the need for the proprietor to draw income from the business during its first fragile and cash-short months. Thus, the allowance would, presumably, help to promote the survival of fledgling enterprises, as well as provide a financial incentive to undertake the entrepreneurial effort.

For Fiscal Year 1988, weekly UC benefits per recipient have been projected to average $141 nationwide, and the average UC recipient currently receives payments for about 14.6 weeks. The self employment allowance, if accepted by that average recipient, would provide this $141 each week between the 14.6 weeks and the exhaustion of that person's UC eligibility, which occurs at about 22 weeks. Thus, the allowance would amount to an extra 7.4 weeks of benefits at $141 per week, or about $1,043.[4]

Program Participation is Likely to be Very Small

How many UC claimants are likely to accept the opportunity which such a self-employment allowance would offer? In British and French experience with similar programs, the answer is: not very many. In both these nations, only a fraction of one percent of persons becoming unemployed elected to receive self-employ-

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[3]It is not clear, in practice, how rapidly UC payments cease for an unemployed person who begins to develop a new business. Once a firm has opened its doors, starts to generate revenues, and issues paychecks to its formerly-unemployed proprietor, then to continue to collect UC payments would clearly constitute fraud. But many new enterprises require a period of weeks or months during which a business plan is developed, financing arranged, business premises are located, equipment and inventories are ordered, and other pre-opening preparations are undertaken. Anecdotal evidence suggests that more than a few future proprietors continue to collect their UC payments during this period, perhaps justifying their actions by conceiving of non-income-generating business development activities as not precluding continued job search. To achieve many of the effects of the proposed self-employment allowances, perhaps all that is required is to continue (or to formalize and legitimize) "benign neglect" in enforcement of the work availability test in these cases.

[4]Data utilized in these estimates are drawn from Background Materials and Data on Programs within the Jurisdiction of the Committee on Ways and Means, 1987 edition, pages 325 and 336.

ment allowances. Furthermore, in many cases, that participation was apparently intended primarily as a means of collecting weekly payments which are higher than regular unemployment payments--a situation wisely precluded in the proposed American system. In 1985, approximately 8.4 million Americans flowed onto the UC claimant rolls nationwide. If we generously assume that one-half of one percent of these persons would elect to receive self-employment allowances, national participation would total 42,000 claimants. Annual program outlays (assuming the $1,043 figure per average participant, calculated above) would total about $44 million.

Thus, the first conclusion which can be drawn about the self-employment allowance proposal is that, even if implemented nationwide, its effect--whether positive or negative--should not be expected to be very large.

Self-Employment Allowances from the UC Claimant's Point of View

Why is participation likely to be so limited? One major reason is that, while "making a million" as head of one's own business is a prominent part of the American dream, it is only an dream for most American entrepreneurs. While small business ownership sometimes generates substantial financial rewards, more typically it offers long hours, few fringe benefits, and only modest earnings. For example, in one recent study of self-employment in the United States and other industrialized nations, median earnings for self-employed men were estimated to average 70 to 80 percent of those of males employed by someone else; the corresponding figure for women was 40 to 70 percent. The work week for self-employed men averaged more than 50 hours, compared to 35 to 40 for wage earners.[5] In the British program comparable to self-employment allowances, among firms still in operation three years after startup, the median earnings of proprietors was about $10,000 a year.[6]

Not only is entrepreneurialism often hard work and modestly paid; the risks of financial disaster are substantial as well. Even modest business enterprises usually demand tens of thousands

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[5]Organization for Economic Cooperation and Development, "Self-Employment in OECD Countries." in OECD Employment Outlook, 1986 (Paris: The Organization, 1986), p.31.

[6]Bendick and Egan, op. cit., especially pp. 531-532.

of dollars in initial investment.[7] Often these financial resources are raised by the proprietor's mortgaging his or her house, investing his or her life savings, or borrowing from close relatives. The chance that a new business in the United States will fail within its first two years of operation averages 50 percent,[8] and comparable failure rates have prevailed in both the British and the French programs of self-employment allowances.[9] It is therefore appropriate for workers to be reluctant to risk the hard-earned assets of themselves and their families.

Successful small business development also often demands of its entrepreneur considerable skills and abilities. The person must have the training and experience required to deliver the goods or services which the business is selling--to be a good locksmith, carpet seller, computer consultant, or whatever. And then he or she must master a range of business management skills as well. Many unemployed persons simply do not have the background or interests to sustain all these demanding roles. Both British and the French experience demonstrate a strong correlation between the probability that a business survives to generate profits and the level of education, training, and work experience of the proprietor.[10] The self-employment approach thus does not provide an easy employment alternative for persons stuck in unemployment because of limited skills and experience. The opposite is more generally true: Self employment takes all the skills which regular employment require and additional ones as well.

Balanced against such risks and prerequisites, a payment of $1,043 is simply too small to induce many unemployed persons not already inclined to do so to undertake self-employment, or to overcome any deficiencies which the proprietor might bring to the

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[7]For example, Venture magazine (November 1987, pp. 37-47) estimates typical minimum startup costs for a McDonald's restaurant at $340,000; only ten franchise operations in Venture's list of 100 largest franchise system could be entered for less than $20,000. Many businesses in both the British and the French self employment allowance programs started with substantially smaller investments than this, such as the $1,500 minimum required by the British program. However, these efforts tended not to survive long or to generate significant incomes for their proprietors.

[8]Norman Scarborough and Thomas Zimmerer, Effective Small Business Management (Columbus, Ohio: Charles E. Merrill, 1984), p. 36.

[9]Bendick and Egan, op. cit. especially pp. 535-536.

[10]Bendick and Egan, op. cit., especially pp. 537-539.

venture. It should be no surprise that a token incentive payment produces only limited participation in response.

Impact on Business and Economic Development

A second benefit often claimed for self-employment allowance programs is that, in promoting the development of new small businesses, they support development of the sector of the American economy which is responsible for the majority of American job growth. Estimates by researcher David Birch are widely cited in support of this contention. His work concluded that small businesses (defined as having twenty or fewer employees) are responsible for two-thirds of all new job opportunities in the United States, a proportion far higher than their share of total employment.[11] By inference, an investment in self-employment allowances is an investment in these engines of overall national growth.

The actual facts of the matter do not support this conclusion.

First, small businesses do not actually generate a disproportionate share of job opportunities. Subsequent research, reanalyzing Birch's data, determined that small businesses (in this case defined as having 100 or fewer employees) actually generate about 40 percent of job openings in the economy, a proportion similar to their share in overall employment.[12] Small, medium, and large companies each contribute their share to job opportunities, and special public support of small enterprises is not justified on this grounds.

Second, new enterprises have no more claim as a special source of economic growth than do small businesses. In fact, quite the reverse. As discussed earlier in this testimony, most new enterprises close soon after opening; among small businesses, that makes them the least attractive for public support seeking to generate growth in employment. Existing small businesses--those that have already survived through their most vulnerable early years and stand poised for expansion--are more appropriate targets for public support to promote job opportunities.[13] Self-

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[11]David L. Birch, "Who Creates Jobs?" The Public Interest 65 (Fall 1981), pp. 3-14.

[12]Catherine Armington and Marjorie Odle, "Small Business--How Many Jobs?" The Brookings Review 1 (Winter 1982), pp. 14-17.

[13]See David J. Storey and Steve Johnson, Small Firms Policies in the U.K. (Newcastle Upon Tyne, England: Centre for Urban and Regional Development Studies, University of Newcastle

employment allowances, of course, do not focus on these existing enterprises but instead expend resources on generating additional startup enterprises, most of which are doomed to be short-lived. Thus, if the federal government wishes to support overall job growth in the United States, self-employment allowances are not an appropriately-targeted means of doing so.

Equally importantly, self-employment allowances are not an appropriate instrument for supporting job growth because they offer an inappropriate scale and form of business assistance. Many small and new businesses face substantial operating challenges, many of which arise from inefficiencies in the operation of private markets; these failures are especially common for firms operated by "non-traditional" entrepreneurs, including women and members of minority groups.[14] Consequently, there are opportunities for federal programs to assist such firms and, in doing so, to improve the growth and performance of the national economy as a whole. Business financing programs managerial training and counseling efforts, and procurement set-asides--of the sort traditionally operated by such federal agencies as the Small Business Administration--can play this role--at least, when they are at their most effective. But such assistance often involves tens of thousands of dollars per job created and requires a multi-year relationship between the assistance agency and the firm being assisted. If the federal government wishes to support the survival and development of new or small business enterprises, then it would be appropriate to reinvigorate and strengthen these existing federal programs.[15] A grant of $1,043 dollars, received once during the first few months of the firm's life, simply would not constitute a meaningful amount of assistance to most firms.

Impact on the Unemployment Compensation System

Given the deficiencies of self-employment allowances both from the point of view of potential recipients and from the point of view of national economic development, one wonders why such an approach is even being suggested. The answer seems to be that, in the current tight-budget federal fiscal environment--within which economic development programs have suffered particularly

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Upon Tyne, 1986).

[14]See The State of Small Business, A Report of the President (Washington, D.C.: U.S. Government Printing Office, 1986).

[15]See Marc Bendick, Jr., and Mary Lou Egan, "Look Who's Becoming an Entrepreneur." Across the Board 24 (January 1987), pp. 52-54.

severe budget cuts[16]--the possibility of obtaining funds from the large UC trust fund is attractive. This is not a sound reason for considering the self-employment allowance approach. In economic development programs, governments all too often offer assistance to business firms in forms which is convenient for government to provide rather than in forms which most usefully assist the firms.[17] The economic development results of that sort of activity are worse than if program monies had never been collected in taxes and instead left in the hands of private business.

The prime responsibility of the UC trust fund must remain that of providing income maintenance to the temporarily unemployed. Alternative uses of these funds for other purposes might be justified if that use so speeds the reemployment process that the expenditures are more than offset by reduced UC payments. Nothing in the evidence reviewed in this testimony suggests that self-employment allowances should be expected to meet this stringent criterion.

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[16]For example, in the first three years of the Reagan administration, total funding for federal economic development program was reduced by more than 61 percent, among the greatest percentage reductions in any field of domestic spending. See Marc Bendick, Jr., "Employment Training and Economic Development," in Isabel Sawhill and John Palmer (eds.), The Reagan Experiment (Washington, D.C.: The Urban Institute Press, 1982), p. 255.

[17]See Marc Bendick, Jr., and David W. Rasmussen, "Evaluating State Economic Development Incentives from a Firm's Perspective." Business Economics 17 (May 1982), pp. 23-29.

Mr. PEASE. Mr. Bendick, thank you very much. I think you've given us a good dose of reality there that we ought to be aware of as we craft this legislation.

Finally, Mr. Rivers.

Mr. RIVERS. First, a small correction to the schedule. My position is associate professor of political science at UCLA.

Mr. PEASE. You're an associate professor of political science?

Mr. RIVERS. Right.

Mr. PEASE. You're not tarred with the brush of being an economist. Good for you. Your credibility rating just went way up. [Laughter.]

Mr. RIVERS. That's a first.

STATEMENT OF R. DOUGLAS RIVERS, ASSOCIATE PROFESSOR OF POLITICAL SCIENCE, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Mr. RIVERS. Over the past 3 years, Jeffrey Dubin, who is an economist at Caltech, and I have conducted a variety of economic analyses of the effects of a productive employment program, or PEP, involving a system of wage subsidies on labor supply and demand, with the aim of determining whether such a program could have a significant effect on the unemployment rate. This qualifies as a possible alternative use of UI funds.

The basic idea of PEP is to provide vouchers to recipients of unemployment insurance in certain welfare programs. Workers would present vouchers to potential employers as an inducement for their hire. Participation in the program would be entirely voluntary. Workers could completely ignore the presence of these vouchers and continue to collect their UI benefits, as under the present system.

Eligibility for participation in PEP would be limited to workers who have valid UI claims and have registered for job search with their State employment offices. Workers on layoff with a definite recall date within four weeks would be excluded.

UI claimants who have been determined to have valid claims receive UI benefits at regular intervals.

Under PEP, the employment service would issue a voucher to eligible UI recipients along with their normal UI benefit payments. The voucher would describe the weekly subsidy amount and number of weeks of subsidy available to an employer hiring the worker. As under the current system, UI benefit payments would cease whenever the worker was employed.

Employers would file for payment of subsidies under PEP on a quarterly basis. Employers who had new UI claims filed against them in the preceding four quarters would be ineligible for reimbursement. Also, an employer could not be reimbursed for rehiring any worker who had previously been on the employer's payroll. These provisions are designed to prevent the displacement of current employees by subsidized hires and the churning of workers.

The amount of the weekly PEP subsidy would be equal to one-third of the worker's weekly UI benefit amount. For each week in which the PEP participant worked 35 or more hours, the employer would be entitled to receive the weekly subsidy amount until the

worker's eligibility expired. The maximum number of weeks the employer could collect the subsidy is equal to twice the number of weeks UI eligibility remaining to the worker at the time the voucher was issued. Thus, the maximum subsidy amount would be two-thirds of the worker's remaining UI benefits at the time he or she found employment.

The basic motivation behind the program is that, although the current welfare and social insurance programs reduce the financial hardship caused by unemployment, they do little or nothing to assist or encourage recipients in finding new employment. By subsidizing wages, the program would lower producers' marginal labor costs and make increased employment and production more profitable than would otherwise be the case. So, it would act as a stimulus to labor demand.

PEP could also have positive effects on the supply of labor. The current UI system imposes a very high effective marginal tax rates on workers receiving benefits. As a consequence, workers have incentives to engage in prolonged search for employment. PEP attempts to eliminate these employment disincentives by allowing employers to use the subsidy to increase wage rates, since the amount of subsidy available to an employee declines the longer the worker is unemployed. Workers are more likely to receive attractive wage offers in the early stages of an unemployment spell. So, the program would encourage early and intensive job search on the part of unemployed workers.

An important feature of the program is that it involves a redirection of current spending commitments towards the creation of jobs in the private sector. The program is designed to be revenue neutral and require a minimum level of administrative supervision. The program could also have a positive counter-cyclical impact, since funding for wage subsidies is tied to benefit levels, which normally increase during recessionary periods.

There is currently a proposal before the California legislature to implement this on a demonstration basis in two counties. We've been analyzing its possible effects if it were to be implemented. We used a survey on income and program participation. The estimated re-employment model was the basis for our analysis of labor supply effects.

Our data show that remaining eligibility for UI benefits leads to a reduction in probability the worker finds an acceptable job offer in any monthly search period. The effect of the PEP subsidy is to transfer two-thirds of the worker's remaining UI benefits to an employer who hires the worker. The employer responds by using the subsidy to increase the worker's wage. The worker would retain two-thirds of his or her UI benefits that would be foregone by accepting a job under the current system.

Thus, the maximum labor supply effect of the subsidy corresponds to the employment incentive that would be caused by two-thirds reduction in the remaining UI benefits. In the SIPP sample, the average unemployment duration was 3.2 months. A wage subsidy of the size proposed in the program would, we estimate, reduce this duration to approximately 2.8 months.

As a consequence, the aggregate number of persons unemployed is forecast to fall by 14.8 percent. Thus, for example, if unemploy-

ment stood at 7 percent, introduction of a PEP-type wage subsidy could be expected to reduce it to about 6 percent.

These estimates assume that the full impact is felt through a shift in the supply schedule. Of course, employers may use some or all of the wage subsidy to reduce net labor costs. In this case, the wage subsidy will stimulate demand rather than supply, which I turn to now.

We've estimated a series of industry-level labor demand functions that related wage costs to industry employment levels. In this framework the program can be viewed as reducing employers' labor costs. An increase in employment and output in one industry increases demand for the outputs of other industries through the first industry's increased demand for inputs, as well as through increased consumer demand for newly hired workers.

We estimate that a 10 percent subsidy of the worker's base wage would result in roughly an 0.7 percent increase in long-run employment levels. For larger subsidies in the 20 percent range, the effects were more substantial, about a 1.3 percent increase in total employment.

Thus, demand and supply effects are roughly the same order of magnitude since the actual effects implementing the program would be a combination of the supply and demand effects. In either case, the implied reduction in the unemployment rate is about one percent.

No simulation results can be entirely conclusive since they rest on assumptions about how workers and employers will respond to the new program and set of incentives. In practice, worker and employer responses may differ from those forecasts of economic theory and past experience, as quite a few experiments have shown.

However, even with these caveats, our analysis is strongly supportive of the wage subsidy approach. Overall, we estimate that, if the PEP program were fully utilized, a reduction in the unemployment rate of about 1 percent is possible. This reduction would provide enough additional tax revenues and decrease in unemployment benefits to reduce the net costs of the wage subsidy. So, in net, it would not cost anything.

Thank you.

[The prepared statement follows:]

STATEMENT BY

PROFESSORS R. DOUGLAS RIVERS AND JEFFREY A. DUBIN

ON

THE PRODUCTIVE EMPLOYMENT PROGRAM (PEP)

ANALYSIS OF THE IMPACT OF THE PRODUCTIVE EMPLOYMENT PROGRAM

Jeffrey A. Dubin and R. Douglas Rivers*

The Productive Employment Program (PEP) was proposed by Allen Davis as a more efficient way of allocating unemployment insurance (UI) and other existing revenue sources to create new jobs and permanently lower unemployment. Mr. Davis contacted us in 1984 and asked us to investigate the feasibility of the PEP program. Since then we have conducted a variety of econometric analyses of the effects of the PEP program on labor supply and demand with the aim of determining whether such a program could have a significant effect on the unemployment rate. We will briefly summarize our findings here.

The basic idea of PEP is to provide vouchers to recipients of unemployment insurance and certain welfare programs. Workers would present vouchers to potential employers as an inducement for their hire. Participation in the program would be entirely voluntary. Workers could ignore the vouchers and continue to collect UI benefits as under the present system.

Eligibility for participation in PEP would be limited to workers who have valid UI claims and have registered for job search with their state employment offices. Workers on layoff with a definite recall date within four weeks would be excluded.

UI claimants who have been determined to have valid claims receive UI benefits at regular intervals. Under PEP the employment service would issue a voucher to eligible UI recipients along with their normal UI benefit payment. The voucher would describe the weekly subsidy amount and number of weeks of subsidy available to an employer hiring the worker. The voucher would expire on the date of issue of the worker's next UI benefit check, at which point a new voucher (with revised subsidy information) would be issued. As under the current system, UI benefit payments would cease whenever the worker became employed.

Employers would file for payment of subsidies under PEP on a quarterly basis. Employers who had had new UI claims filed against them in the preceding four quarters would be ineligible for reimbursement under PEP. Also, an employer could not be reimbursed for rehiring any worker who had previously been on the employer's payroll. These provisions are designed to prevent the displacement of current employees by subsidized hires and the churning of workers.

The amount of the weekly PEP subsidy would be equal to one third of the workers' weekly UI benefit amount. For each week in which the PEP participant worked thirty-five or more hours, the employer would be entitled to receive the weekly subsidy amount until the worker's eligibility expired. The maximum number of weeks an employer could collect the subsidy is equal to twice the number of weeks of UI eligibility remaining for that worker at the time the voucher was issued. Thus, the maximum subsidy amount would be two-thirds of the worker's remaining UI benefits at the time he or she found employment.

*Dr. Dubin is an Assistant Professor of Economics at the California Institute of Technology. Dr. Rivers is an Associate Professor of political science at the University of California, Los Angeles.

The basic motivation behind the PEP program is that although current welfare and social insurance programs reduce the financial hardship cause by unemployment, they do little or nothing to assist or encourage recipients in finding new employment. By subsidizing wages, PEP lowers producers' marginal labor costs and makes increased employment and production more profitable than it otherwise would be. That is, PEP would act as a stimulus to labor demand.

PEP could also have positive effects on the supply side of labor. The current UI system imposes a very high effective marginal tax rate on workers receiving benefits. As a consequence workers have incentives to engage in prolonged search for employment. PEP attempts to eliminate these employment disincentives by allowing employers to use the subsidy to increase wage rates. Since the amount of the subsidy available to an employer declines the longer the worker is unemployed, workers are more likely to receive attractive wage offers in the early stages of an unemployment spell. Thus PEP encourages early and intensive job search on the part of the unemployed worker.

An important feature of the PEP program is that it involves a redirection of current spending commitments toward the creation of jobs in the private sector. The program is designed to be revenue neutral and to require a minimal level of administrative supervision. The program could also have a positive countercyclical impact since funding for wage subsidies is tied to benefit levels which normally increase during recessionary periods.

The relevant policy questions in assessing both the demand and supply effects of PEP do not concern the direction of the effects -- they clearly increase both supply and demand -- but the size of these effects. How much employment can PEP be expected to generate? How long will workers spend searching for employment with PEP compared to the present system? Will expenditures on UI benefits be reduced sufficiently to cover the cost of the PEP wage subsidies?

Since the PEP program has not been implemented on a large scale, it is impossible to estimate its effects without making assumptions about how workers and employers would respond if a system of wage subsidies were put in place. We adopt the usual assumptions of economic analysis: workers and employers will only undertake actions whose benefits exceed the costs incurred, including opportunity costs. Workers will not accept a job unless the net wage offered (plus any non-pecuniary benefits of working, such as the value of the experience gained) exceeds the value the worker attaches to not having to work. Employers will only offer a wage to a worker who has a PEP voucher if the worker's marginal revenue product exceeds the wage offered, less any subsidy available. We have used historical data to estimate labor supply and demand behavior. We have then simulated the econometric models to determine the likely effects of introducing PEP-type wage subsidies.

The econometric estimates of supply and demand effects are extrapolations from historical behavior. In the final section we discuss the results of a wage voucher experiment conducted by the Illinois Department of Employment Security which supports some of our estimates.

SUPPLY EFFECTS

We used the Survey on Income and Program Participation (SIPP) to estimate a reemployment model that is the basis for our analysis of labor supply effects. SIPP is a panel study of approximately 15,000 housing units that provides very detailed information on program participation and labor force status. For each unemployed person in the SIPP sample, we estimate a monthly reemployment probability as a function of various demographic indicators and program participation variables. The effects of changing the structure of the UI program can be simulated by appropriate modification of the program participation variables. The estimates reported below represent aggregate effects obtained by summing the simulated individual effects over the sample. The estimates apply to the period covered by our data (1984-85).

Our data provide clear evidence that remaining eligibility for UI benefits leads to a reduction in the probability that a worker finds an acceptable job offer in any monthly search period. The effect of the PEP subsidy is to transfer two-thirds of the worker's remaining UI benefits to an employer who hires the worker. If the employer responds by suing the subsidy to increase the worker's wage, the worker would retain two-thirds of his or her UI benefits that would be foregone by accepting a job under the current system. Thus, the maximum labor supply effect of the PEP subsidy corresponds to the employment incentive that would be caused by a two-thirds reduction in remaining UI benefits. Of course, employers may use some or all of the wage subsidy to reduce net labor costs. In this case, the wage subsidy will stimulate demand rather than supply. Demand effects are discussed in the next section.

In the SIPP sample, the average unemployment duration was 3.2 months. A wage subsidy of this size proposed in the PEP program would reduce this duration to 2.8 months. As a consequence, the aggregate number of persons unemployed is forecast to fall by 14.8 percent. Thus, if unemployment stood at 7 percent, introduction of a PEP-type wage subsidy could be expected to reduce it to about six percent. As stated above, these estimates assume the full impact is felt through a shift in the supply side schedule. Details of the supply estimates are provided in the report contained in Annex C.

DEMAND EFFECTS

Our initial study of the effects of PEP (see the report appended as Annex A) addressed the question of whether a UI-funded wage subsidy could have substantial effects on employer demand for labor. We estimated a series of industry-level labor demand functions that related wage costs to industry employment levels. In this framework, PEP can be viewed a reducing employers' labor costs. (Of course, PEP subsidies can also be used to increase the wage an employer offers to a worker, resulting in supply effects as discussed above. The estimates reported below represent the maximum demand stimulus possible from PEP. Actual effects would be a combination of supply and demand effects.)

In the demand study, we also analyzed the macroeconomic consequences of PEP through inter-industry flows of goods and services. An increase in employment and output in one industry increases demand for the outputs of other industry through the first industry's increased demand for inputs as well as through increased consumer demand from newly hired workers. These multiplier effects were analyzed using both an input-output model and a reduced form industry demand model.

The degree to which PEP stimulates employment depends, of course, on the level of wage subsidy. A subsidy equivalent to 30% of the worker's base wage was estimated to increase employment by over 2%. A 10% subsidy was shown to have a more modest, though not insignificant, impact with about a 0.7% increase in long run employment levels. For larger subsidies -- in the 20% range -- the effects were more substantial (about 1.3% increase in employment). Thus, demand and supply effects are roughly the same order of magnitude. Since the actual effects of implementing the program would be a combination of the maximum estimated effects, in either case the implied reduction in the unemployment rate is about one percent.

EXPERIMENTAL EVIDENCE

The estimates of the unemployment rate reductions, if feasible, would make the PEP program appear quite attractive. Several questions remain, however, about the practical feasibility of such a program. Specifically, can such a program really be self-financing? Will workers and employers utilize wage subsidies if offered? The best evidence on these points comes from pilot studies which have actually implemented PEP-type wage subsidies.

During 1980-81, a targeted wage subsidy pilot program was undertaken in Dayton as part of the CETA program. The availability of a wage subsidy voucher did not appear to improve the job placement rates of program participants. (In fact, the group of workers receiving wage subsidy vouchers had lower placement rates than control group members.) There are several possible explanations for this negative result. First, the participants in the pilot program were composed of AFDC and general assistance beneficiaries with little prior work experience. Second, participation was mandatory for the general assistance recipients who would otherwise have forfeited their benefits. Third, the sample size was very small. (Only 38 job placements occurred under the program and of these only 14 employers filed for reimbursement.) These results appear to have little bearing on the feasibility of a large scale voluntary program for UI recipients.

A recent pilot program conducted by the Illinois Department of Employment Security is more relevant to an evaluation of the PEP program. In the Illinois experiment, wage subsidy recipients had, on average, a 3.3% decrease in the number of weeks unemployed. The average UI benefit paid to the subsidy group decreased about 4.8 percent (from $2,558 to $2,446). The wage subsidy consisted of a single payment to the employer of $500 if the worker was hired before expiring 13 weeks of UI benefits. The subsidy was paid in only 2.8% of the cases, resulting in a benefit-cost ratio of 8:1 ($114 in benefits to $14 in costs). There was some tendency of subsidized hires to suffer additional spells of unemployment later, but it is quite difficult to determine the exact magnitudes of these effects without much larger samples. The Illinois results suggest that such a program can be self-financing.

The primary practical consideration that emerges from the pilot studies concerns the low utilization rate of wage subsidies by both workers and employers. Few claims for reimbursement are made under the wage subsidy programs either because workers do not inform their employers of their eligibility or employers do not choose to collect the subsidy owed them. The low utilization rates are a mixed blessing. First, there is little chance that a subsidy program could turn out to be a costly venture given the reluctance of workers or employers to fully utilize their benefits. On the other hand, low utilization means correspondingly smaller employment effects. To ensure the greatest degree of participation possible, it is essential that the simplicity of the PEP program be maintained.

Clearly, complicated schemes of targeting and employment rules will make the potential employment effects of a wage subsidy program that much harder to attain.

CONCLUSIONS

No simulation results can be entirely conclusive since they rest on assumptions about how workers and employers will respond to a new program and set of incentives. In practice, of course, worker and employer responses may differ from those forecast by economic theory and past experience. However, even with these caveats, our analyses are strongly supportive of the PEP program. Overall, we estimate that if the PEP program were fully utilized, a reduction in the unemployment rate of about one percent is possible. This reduction would provide enough additional tax revenues and decrease in unemployment benefits to cover the net costs of the wage subsidy.

Mr. PEASE. All right. Thank you very much, Mr. Rivers. I appreciate that testimony.

Mr. Levin, why don't you begin.

Mr. LEVIN. Thank you. In terms of the last testimony, we have on the books a tax credit. Right? The targeted jobs tax credit? Have you looked at how that works in relationship to this proposal?

Mr. RIVERS. We have not studied that directly, though other people have. The approach of the wage subsidy is to simplify the matter, so that the person who is doing the hiring in a firm can directly see what the costs will be. So, it seems that simplicity in the administration of these programs is the key to making them work.

Mr. BENDICK. It is also important to keep in mind that there is a distinction between the experience of a program like the targeted jobs tax credit and a slightly different program called the new jobs tax credit. Where the targeted jobs tax credit focuses on taking individuals within the pool of the unemployed who are standing at the end of the job queue—welfare recipients, or ex-offenders, or a number of people who are not particularly first choice of employers—programs like the new jobs tax credit are used more as a macroeconomic stimulus to increase total employment; there's no need for the particular worker being aided to be a particularly unattractive type of worker.

The new jobs tax credit experience, as analyzed by Prof. John Bishop at Cornell University, has been quite favorable. According to that research, it apparently has had a rather positive effect on total job creation and macrostimulation of the economy.

Mr. LEVIN. Let me just say a word about the testimony on self-employment allowances, especially page 6. It ties in to the proposal of Mr. Pease and myself that I will be saying a few more words about later. But, this gives me a chance to kind of testify seriatim.

You say on page 6: One wonders why such an approach is even being suggested. And then you say: The answer seems to be that in the current tight-budget Federal fiscal environment, within which economic development programs have suffered particular budget cuts, the possibility of obtaining funds from the large UC trust fund is attractive.

I don't really think that's the origin of the idea or, really, its stimulus. For a number of us, it's a very small piece of a larger approach. It's an effort to force us to look our unemployment comp system in terms of today's work force and today's business needs and to compare it with 20 years ago.

And the notion that one would allow people to use a piece of unemployment comp for self-employment is a tiny portion of this larger idea. I think it would be readily acknowledged that it would be applicable to a small number of people. It would have to be considerably limited.

But the question is whether it should not be a small portion of a larger approach of a larger change. I think there is a tendency to assume that the availability of money is what causes ideas around here. And that sometimes happens.

But sometimes the problem stimulates the new ideas, not just the money. And, so, I plead innocent to your charge, as I think Mr. Pease would.

At the same time, I think we welcome your criticism of it. But I remember, and I'm sorry I don't have it here, an article from the Wall Street Journal about the number of small entrepreneurs in America who tried their talents during a given year. It was interesting as they traced—and this was in the news columns, not the editorial columns—what is the dynamic of efforts to start a business. And they traced the amount of money many used to generate a small enterprise.

That rather persuaded me that we should not dismiss this idea altogether. I mean, do you dismiss it altogether? You'd be opposed to any further experimentation with it?

Mr. BENDICK. I think that what is needed to generate a constant stream of new job opportunities in the economy is some very sound programs in terms of Government support of small business—as well as other kinds of business enterprises—of the types that you've seen, for example, in the Small Business Administration loan programs, minority business assistance programs, and 8(a) set-asides in procurement. Those are programs. You were talking before about a small piece of a fundamental structure. We have a structure in Federal policy for business development. And I think that generally the ways to strengthen the employment opportunities through self-employment, of the kind that these self-employment alliances are groping toward, is really to strengthen those sorts of programs, rather than to attach a small piece on to the unemployment compensation system.

Mr. LEVIN. Right. So, just to finish my thought, if you were running an unemployment comp office as a practical chairman, let's say somebody who was a rather skilled mechanic on an assembly line comes in and he or she is laid off. And they come in with evidence that there is a need in this particular area for more repair shops—and I think there is in a number of areas, including this one—and that person convinces you of their skills, of their judgment, et cetera, I think the issue is whether under any circumstances the person could use any portion of their unemployment comp benefits for starting a small enterprise.

Mr. BENDICK. Well, in the balance of things that person would need to get going, I would suggest that the thousand dollars or so suggested by this allowance program would not be terribly significant assistance. But I should also point out something which is in a footnote in my written statement, which is that that person probably, in today's U.C. system, can go ahead and develop and start up his business and still receive unemployment compensation for a number of weeks anyway, in the sense that prior to the point that that business starts generating revenues and that person starts drawing pay from that business, it is not clear that the unemployment claims office clamps down on that person as unavailable.

Mr. LEVIN. The certification is, "I am available for full time work." That is the certification, unless it has changed since I last saw it.

Mr. BENDICK. But there is often a period of quite a number of weeks—say in the case of that mechanic, where the mechanic might be going around looking for premises, buying equipment, drawing up partnership agreements, trying to raise a loan from the bank, doing all sorts of things that are not generally revenue gen-

erating. He does not, by some tests, look terribly employed at that point.

And it may be a matter of judgment on his own part whether he declares himself available for work or not. But anecdotal evidence suggests that a lot of people simply continue to collect. That fulfills what seems to me 99 percent of the purpose of setting up this more formal allowance.

Mr. LEVIN. So your answer is, in certain circumstances, people ought to be able to use it to help start up a business, but they ought to fib a little.

I mean, because in a sense, isn't that what it is?

Mr. BENDICK. Well, I refer to this in the written testimony as "benign neglect" in enforcement. It might be that the committee would want to consider formalizing and legalizing this process in some way.

Mr. LEVIN. I missed your footnote. Thanks.

Mr. PEASE. OK, thank you very much, Mr. Levin.

Again, I'd like to thank this panel. You have provided quite a different component from that of the previous one made up of practitioners, but one I think which is very helpful to the committee.

Mr. Vroman, you have given us some helpful figures on the number of States that would have triggered on for EB using a TUR versus using an IUR. And that is precisely why Mr. Clinger and others and I have tried to substitute the TUR.

I am pleased that you think it is helpful.

Mr. VROMAN. Congressman, I feel an obligation to workers in States like Texas and Florida who, under the current configuration of their UI program, would have to have TUR's above 20 percent for the IUR to get to 5 percent.

Mr. PEASE. Exactly right. That's what struck me, during 1983 and 1984, we had some States, West Virginia comes to mind, with an extremely high TUR rate.

They were triggering off of IUR. It just did not seem to make any sense to me.

OK, Mr. Nicholson, you have given us useful information about not fine tuning too much on durations and trigger dates. I wanted to know what you thought about sub-State triggers.

Does that constitute fine tuning as well, or what do you think about sub-State triggers?

Mr. NICHOLSON. Well, thank you.

Let me say, first, I was pleased in the endurability of certain numbers—a number we more or less invented in a book on FSB that each percentage increase in the IUR would lead to a 3 to 5 week increase in potential duration seems to have made it into the bill.

I do not know whether it is exactly our number, but I am pleased to see that duration is tied to labor market conditions, although I wouldn't put great faith in our specific number.

In any case, the sub-State trigger seems to be a very difficult problem. I am only partly aware of the magnitude of sub-State data availability and the problem, mentioned earlier, of place of work versus place of residence differences in the data seems to me severe.

I think as a general principle, targeting benefits to weak labor markets, if they can be defined, is a good idea.

I think practical problems may be virtually insurmountable in this case. But I do not have a well informed opinion at the moment.

Mr. PEASE. Does anybody else have any experience at all, or have any of you thought about the sub-State trigger problem?

If not, I would just invite you, as you circulate around your academic friends, to suggest that here is a subject they might want to look into.

OK, Mr. Bendick, now all along I tried to tell Mr. Levin that that was an idea that was not going to fly, and he just insisted on putting it in anyhow.

Mr. LEVIN. It is 1 percent of the bill. We have to give up something before we pass it.

Mr. PEASE. In any event, as I mentioned earlier, Mr. Levin is motivated by the most pure and desirable motivation. And I am, too. I think we've been struggling together for 2 or 3 years now to try and get some system which would be more responsive to the conditions we ran into in 1982 and 1983 than was the system in place at that time.

And I think this idea of the possibility of entrepreneurship is worth trying.

You seem to suggest from some empirical data that maybe it is not worth trying. And I feel that we are indebted to you for bringing that information to our attention.

Mr. Rivers, I am pleased with your testimony as well on the voucher system. Particularly, you seem to have gotten into a rather significant level of detail on how the system would work out.

Do I understand from you that the system you describe is not now being employed anywhere, but that there is a two country demonstration project in California?

Mr. RIVERS. There is a proposal for a project we are testifying later this week on in Sacramento.

Mr. PEASE. In Sacramento? So right now, this is a program that you have developed, though, is that right?

Mr. RIVERS. Right. The thing we have analyzed has gone through various modifications. It was proposed by a California businessman who set up a foundation to study unemployment related problems.

Mr. PEASE. I see. Well, that is a good piece of work. Well, thank you all, gentlemen, very much. We appreciate it.

Our next panel will be made up of James Ellenberger, representing the AFL–CIO; Mark Levinson, accompanied by Benny Robinson, representing the UAW; Charles Hughes, accompanied by Charles Loveless, representing the American Federation of State, County & Municipal Employees; and Pat Dicks, representing the National Educational Association.

Welcome. We are pleased to have you here. Let us begin with Mr. Ellenberger.

STATEMENT OF JAMES N. ELLENBERGER, ASSISTANT DIRECTOR, DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH, AND SOCIAL SECURITY, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. ELLENBERGER. Thank you very much, Mr. Chairman. I want to congratulate you and thank you for your interest in this issue, and your persistence in helping to bring about these hearings, very important hearings.

And I would like to abbreviate some of my remarks. I am going to skip around a little bit and hit highlights in my prepared testimony.

I would just ask that the entire testimony be submitted into the record.

I would also like to comment just briefly on something that astounded me and perhaps others in this room who either watched one of the news programs yesterday or read the paper this morning, and found out that the Vice President was not aware that 37 million Americans go without health insurance.

Nor was he aware that 7 out of 10 Americans who are unemployed go without unemployment benefits.

It is a pleasure to come before a panel that has members, elected officials, who are certainly aware of the problem.

Mr. PEASE. Better to be informed than to be Vice President. [Laughter.]

Mr. ELLENBERGER. The problem, Mr. Chairman, as you know, is that we are presently compensating just 32 percent, the 11-month average for 1987, 32 percent of the unemployed in this country. And we are not compensating any of the long term jobless at the present time.

In 1975, we were compensating 76 percent of the jobless. The AFL–CIO has been appearing before the committee for many years urging basic reform in the Nation's unemployment insurance program.

For the past several years, we have focused on the fact that the vast majority of the unemployed were not being protected by the current program, and that the extended benefit program for long term unemployed offered virtually no protection to those out of work 27 weeks or more.

I would like to submit for the record, Mr. Chairman, the attachments to my testimony, which include two factsheets on unemployment compensation that were adopted by the AFL–CIO executive council, one in February of 1986 and one in February of 1987, and the most recent policy resolution that was adopted at our convention in October of this year.

Since 1984, our Federal-State unemployment insurance system has achieved and continued the dubious record of compensating just one out of three of the unemployed. The tragic human consequences of this failed policy is that each month, well in excess of 5 million jobless Americans go without benefits from this program.

There are a number of problems that the committee has listed for which you have invited our response, and those are included in my testimony.

I do want to point out that in addition to the problem of uncompensated unemployment, and the particular problem that faces the long term jobless, the value of unemployment compensation benefits has declined.

The National Commission on Unemployment Compensation, in its report to the President and to the Congress in 1980, concluded that one of the goals of the UI system was to ensure that benefits be related to prior earnings; and that each State provide a weekly benefit amount between the minimum and maximum weekly benefit, which averages at least 50 percent of the individual's average weekly wage.

The average weekly benefit as a percentage of the average weekly wage has declined each year since 1982. Last year the replacement rate was just 35 percent of the average weekly wage.

This Nation, over the past 7 years, has suffered extraordinarily high rates of unemployment. Although the jobless rate has declined to about 6 percent, we continue to have the highest unemployment rate in an economic expansion ever experienced in this country.

Each month, well in excess of 7 million people are without jobs.

Mr. Chairman, this situation is a direct result of deliberate actions that have taken place at the Federal level, and in States around the country, to turn the UI program away from compassion, concern, and assistance for the unemployed, the harsh restrictions against UI eligibility.

In addition to the actions that have taken place at the Federal level, all across the country, States have enacted changes requiring that people work longer and earn more in order to qualify for unemployment insurance benefits.

Since 1982, 33 States have increased their qualifying requirements. Additionally, disqualification measures have been changed in many jurisdictions.

In 23 States, since 1982, disqualification provisions have been made more stringent.

It makes it far easier for employers to contest claims, and for State agencies to avoid paying claimants their jobless benefits.

The response of the administration and the Department of Labor, in our view, has been sadly, sadly deficient. About the only new program the Department of Labor has instituted over the past 7 years has been the quality control program, the program with which we have had very serious problems, and have exhibited—we have demonstrated our unhappiness with it, and on a number of occasions, with the Department and others in the administration, we have detailed to a considerable extent our unhappiness with it.

And the basic reason we are unhappy with the quality control program, and we take second place to no one when it comes to quality, and we want to make sure that the system functions as it is intended, but the Department of Labor is focusing solely on claimants.

They are auditing a certain number of claimants each year. It is mandatory in all states.

We told the Secretary of Labor in 1985 that to have a true quality control program, you would have to include all elements of the

unemployment compensation system. Do not just audit claimants. Audit tax collections. Audit UI denials.

The Department was supposed to include those elements into the program in 1985. They are still under consideration; they are under study.

The initial thrust of the quality control program, that to audit UI claimants, is going forward. The audits of revenue collections, the audits of denials, we are told, will be implemented at some point in the future, how far, we are not sure.

The problem, in our view, is that no one at the Department has addressed how one goes about auditing 5 million people each month who go without unemployment benefits.

Another issue that has been commented on several times today in the course of the hearing is what we refer to as the devolution proposals. Devolution, according to the Department of Labor, which formerly used that term, is now called administrative reform.

It is a proposal that involves a scheme to return or to shift the responsibility of funding state administrative expenses in the UI system from the Federal Government to the States.

As you know, since the inception of the Nation's unemployment insurance program over 50 years ago, the administrative costs at both the Federal and State level are funded by the Federal Government from funds collected through the Federal unemployment tax.

Under devolution, States would be forced to either raise taxes or to reduce benefits in order to provide sufficient resources for administrative expenses.

Such a scheme would seriously weaken the Federal role in the Nation's UI system, making it difficult if not impossible to move toward fair and equitable standards.

We heard earlier some comments about winning States and losing States under the allocation provisions, and under the way in which administrative funding takes place.

The only losers in this system are the unemployed people who go without benefits. There are changes in our economy. We have seen the shift in high unemployment from the Midwest to the Southwest and to the South. And as those shifts take place, States require more support than they previously got.

And that is what the system is designed to do. It is a social insurance program. And that is why it is important to retain the concept of Federal involvement, and to make sure that we can cover those demands when they arise and are placed on the system.

The problem has become exacerbated recently. Fueling the interest in devolution as a serious problem is the way administrative expenses of State agencies have been handled by the administration and by the Congress.

We represent not only members who are going into unemployment insurance offices and claiming benefits, we represent thousands and thousands of people who work in those offices.

Unions at this table represent workers in those offices.

Since 1981, the administration has requested insufficient amounts for the administration not only of the unemployment insurance program, but also the employment service.

The result has been that the number of unemployment insurance personnel at the State level has been cut by over 3,000, and close to

300 unemployment insurance offices have been closed around the country.

Even though sufficient amounts are currently being collected through the FUTA tax to fund State UI programs, the amount being appropriated is shrinking due to the inclusion of these trust funds in the Federal unified budget.

This encourages Congress to use these surpluses as an offset to the overall Federal deficit, despite the fact that these funds cannot be used for any purpose other than the administration of the UI program.

The UI system is faced with inadequate reserves, presently, and certainly as we look down the road to the next recession. And in our view, this is central to the problem of the whole unemployment compensation system.

The reason reserves are inadequate is that the taxable wage base established by the Federal Government is insufficient to create the reserves that most experts consider necessary to meet actuarial guidelines for those reserves.

The ratio of wages subject to UI taxes was 98 percent in 1939, while today it is less than 30 percent.

The Federal taxable wage base has been changed four times since 1939. In 1940, it was limited to the first $3,000 of wages; 47 years later, today, it is just $7,000.

The result has been a chronic and serious underfunding of the UI system.

We have detailed, Mr. Chairman, in our submission, in considerable detail, some of our proposals in terms of reforms. Let me just mention four of those.

We think Congress ought to remove the restrictions that had been instituted over the past 7 years that have resulted in so few of the unemployed getting jobless benefits.

We think that we should improve the funding of the system by indexing the Federal taxable wage base to at least 65 percent of the average weekly—average annual wage, as recommended by the national commission 7 years ago.

We think that Congress should reform the criteria for eligibility for extended benefits, and we congratulate you and your colleagues for the bill that you have submitted to the Congress.

We think that State triggers ought to be eliminated. That would also eliminate the problem of sub-State triggers.

And we think that there ought to be the establishment of Federal minimum benefit standards to ensure fair treatment for all jobless workers.

Mr. Chairman, we appreciate you and your colleagues recognizing the need to reestablish a system for providing benefits for long term jobless.

While we feel that H.R. 2676 does not do everything that would be necessary to establish a fully effective extended benefit program, it does provide for some protections for the long term jobless.

We testified in some detail on an earlier version of your proposal last year. Unfortunately, the trigger levels proposed by the bill would have prevented most long term jobless from qualifying from extended benefits, even in the depths of the last recession.

We do have some doubts about the self employment section of that bill, and Congressman Levin's H.R. 3213.

We testified, Mr. Chairman, before this committee in March of last year on the issue of alternative uses of unemployment compensation trust funds to aid dislocated workers.

It is our firm conviction that the Nation's UI system should provide temporary income support to jobless workers. Other programs targeted at displaced or dislocated workers are needed, but they should be funded separately.

We are opposed to the diversion of UI trust fund moneys or taxes to programs unrelated to that goal.

We stand ready and we look forward to working with you and the committee on these issues.

Thank you.

[The statement of Mr. Ellenberger follows:]

87-54

**STATEMENT OF JAMES M. ELLENBERGER, ASSISTANT DIRECTOR
DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS
BEFORE THE SUBCOMMITTEE ON PUBLIC ASSISTANCE
AND UNEMPLOYMENT COMPENSATION OF THE
HOUSE COMMITTEE ON WAYS AND MEANS
ON UNEMPLOYMENT COMPENSATION**

DECEMBER 14, 1987

Mr. Chairman, we appreciate the opportunity to present to this Subcommittee the views of the AFL-CIO on the need to reform the Federal-State Unemployment Compensation system.

It is a source of concern and a mystery to us that the Congress, the Administration and the media have largely ignored the failure over the past several years, of this nation's unemployment insurance program to provide benefits to the vast majority of unemployed. In an editorial on Sunday, November 29, the Washington Post noted the erosion of the historic protections of the unemployment insurance system and lamented the fact that it was occurring "with surprisingly little debate."

The shocking event that brought about this editorial was the fact, as reported by the Center on Budget and Policy Priorities, that just 25.4 percent of the unemployed received unemployment insurance benefits in October. Unfortunately, Mr. Chairman, the figures have been shocking for more than just one month. For the past four years seven out of every ten jobless workers have failed to get UI benefits.

The AFL-CIO has been appearing before this Committee for many years urging basic reform in the nation's unemployment insurance program. For the past several years we have focused on the fact that the vast majority of the unemployed were not being protected by the current program and that the Extended Benefit program for long-term unemployed offered virtually no protection to those out of work for 27 weeks or more. I would like to submit for the record Mr. Chairman, the attached statements that have been adopted by the AFL-CIO. There are two fact sheets on the crisis in the unemployment insurance program, one from February 1986 and another from February 1987, adopted by the AFL-CIO Executive Council, and there is a resolution that was adopted at our recent convention in October of this year.

Since 1984, our Federal-State unemployment insurance system has achieved and continued the dubious record of compensating just one out of three of the unemployed. The tragic human consequences of this failed policy is that each month well in excess of five million jobless Americans go without benefits from this program.

There are other shortcomings in the unemployment insurance system. This Committee recognizes there are serious problems in terms of providing compensation to those who remain unemployed for twenty-seven weeks or longer due to the failure of the Extended Benefit program. We have the continuing problem of inadequate levels of unemployment insurance benefits. The National Commission on Unemployment Compensation in its report to the President and to the Congress in 1980, concluded that one of the goals of the UI system was to insure that benefits be related to prior earnings and each state "provide a weekly benefit amount between the minimum and maximum weekly benefit which averages at least 50 percent of the individual's average weekly wage." The average weekly benefit, as a percentage of the average weekly wage, has declined each year since 1982. Last year the replacement rate was just 35 percent of the average weekly wage. Another problem has been the failure of policy makers at both the Federal and State levels to provide for adequate funding and reserves in the state unemployment insurance trust funds. All of these problems contribute to the failure of the system to provide benefits to all but one-third of the jobless.

This nation, over the past seven years, has suffered extraordinarily high rates of unemployment. Although the jobless rate has declined to about six percent, we continue to have the highest unemployment rate in an economic expansion ever experienced in this country. Each month well in excess of seven million people are without jobs. Yet, since 1984 we have compensated just one-third of the jobless. Mr. Chairman this situation is the direct result of deliberate actions that have been taken at the federal level and in states around the country to turn the UI program away from compassion, concern and assistance for the unemployed to harsh restrictions against UI eligibility.

Why is it that we are compensating so few of the jobless in our society? A number of factors are responsible for this development. The Omnibus Budget Reconciliation Act of 1981 eliminated the national trigger and raised the levels of the automatic and optional state triggers. Extended benefit recipients were excluded from the computation which had the effect of lowering the insured unemployment rate. Additionally the cost of indebtedness to those states forced to borrow from the federal government to meet benefit obligations was increased by the imposition of interest charges. States were also encouraged to make their systems more restrictive, through so-called "solvency efforts", in order to qualify for FUTA tax credit reductions. All across the country states have enacted changes requiring that people work longer and earn more in order to qualify for unemployment insurance benefits. Since 1982, 33 states have increased qualifying requirements. Additionally, disqualification measures have been changed in many jurisdictions (in 23 states since 1982) making it far easier for employers to contest claims and for state agencies to avoid paying claimants their jobless benefits.

Following those actions in the early 1980s, the Administration and the Congress permitted the Federal Supplemental Compensation program to expire in March 1985. That action resulted in the loss of benefits to over 340,000 long-term jobless workers.

Unfair Quality Control Program

What has been the response of the Department of Labor in the face of this callous treatment of the unemployed? In 1985, the Department announced the mandatory "quality control" program which would have required each state to audit up to 1,600 UI benefit recipients each year. The AFL-CIO and a number of other organizations complained to the Secretary of Labor that this program was discriminatory to UI claimants and was unfair due to its failure to include other elements of the UI system as part of a "quality control" program. In fact, Mr. Chairman, the evidence strongly suggests that the most serious problem is not the overpayment of benefits to claimants but the failure of the system to insist that employers pay their taxes in a timely and accurate fashion. In 1985, the Secretary of Labor told the AFL-CIO and others that the Department would redesign the QC program to include audits of tax collections and audits of unemployment insurance denials as part of the overall program. It is now the end of 1987 and the inclusion of those two important ingredients in the Quality Control program has not taken place. Yet each state is currently being required to audit a certain number of UI recipients each year. One does not have to be a genius to figure out that the impact and the net effect of the present QC program will simply be to make the system more restrictive and will result in even fewer unemployed persons receiving benefits.

Devolution

Another issue that has received a tremendous amount of attention on the part of the federal government and the Department of Labor over the past several years has been the promotion of a new scheme commonly referred to as "devolution" or defederalization. Under devolution, the responsibility for funding state administrative expenses in the UI system would be

transferred from the federal government to the states. As you know, since the inception of the nation's unemployment insurance program over 50 years ago, the administrative costs at both the federal and state level are funded by the federal government from funds collected through the Federal Unemployment Tax (FUT). Under devolution, states would be forced to either raise taxes or to reduce benefits in order to provide sufficient resources for administrative expenses. Such a scheme would seriously weaken the federal role in the nation's UI system making it difficult if not impossible to move toward fair and equitable standards.

Administration of the Program

Fueling the interest in devolution is the serious problem in the way administrative expenses of state agencies have been handled by the Administration and by the Congress. Since 1981 the Administration has requested insufficient amounts for the administration of not only the unemployment insurance program but also the employment service. The result has been that the number of unemployment insurance administrative personnel at the state level has been cut by nearly 3,000, and close to 300 unemployment insurance offices have been closed around the country. Even though sufficient amounts are currently being collected through the FUTA tax to fund state UI programs, the amount being appropriated is shrinking due to the inclusion of these trust funds in the federal unified budget. This encourages Congress to use these "surpluses" as an offset to the overall federal deficit despite the fact that these funds cannot be used for any purpose other than the administration of the UI program.

System Underfinanced

One of the major problems in the nation's unemployment insurance system is that the program is underfunded. Even though all but a few states have eliminated the deficits in their trust fund accounts, the UI system is faced with inadequate reserves for the next recession. The reason the reserves are inadequate is that the taxable wage base established by the federal government is insufficient to create the reserves that most experts consider necessary to meet actuarial guidelines for those reserves. The ratio of wages subject to UI taxes was 98 percent in 1939 while today it is less than 30 percent. The federal taxable wage base has been changed four times since 1939. In 1940 the FUTA tax was limited to the first $3,000 of wages, 47 years later in 1987 it is just $7,000. The result has been a chronic serious under-financing of the UI system.

Elements for Reform

Mr. Chairman the AFL-CIO has detailed, as evidenced in the attached resolutions and statements, its recommendations for improvements in the federal-state unemployment insurance system. To summarize those recommendations, the AFL-CIO is calling for action by Congress that will:

- Remove restrictions that have been instituted over the past seven years that have resulted in so few of the unemployed getting jobless benefits.
- Improve funding by indexing the federal taxable wage base to at least 65 percent of the average weekly annual wage.
- Reform the criteria for eligibility for extended benefits. State triggers should be eliminated.
- Establish federal minimum benefit standards to insure fair treatment for all jobless workers.

Before closing, I would like to comment on two bills that are under consideration by this Subcommittee, H.R. 2676, The Extended Unemployment Insurance Act of 1987, and H.R. 3213, The Unemployment Insurance Re-Employment Demonstration Projects Act. As we noted in June of last year, the AFL-CIO is pleased that Congressman Pease and his distinguished colleagues recognize the need to reestablish a system of providing benefits to the long-term jobless. While we feel that H.R. 2676 does not do

everything that would be necessary to establish a fully effective extended benefit program, it does provide for some protections for the long-term jobless. We testified in some detail on an earlier version of this proposal in June of 1986. Unfortunately the trigger levels proposed by this bill would have prevented most long-term jobless from qualifying for extended benefits even in the depths of the 1982-83 recession. The AFL-CIO does have serious doubts about Section 301 of H.R. 2676, the Self-Employment section of that bill. Similarly, we have serious questions about major portions of H.R. 3213. In both cases, we are opposed to the use of unemployment trust funds to carry out demonstration projects beyond purposes that are specified by the Social Security Act of 1935.

We testified Mr. Chairman before this Committee in March of last year on the issue of alternative uses of unemployment compensation trust funds to assist dislocated workers. It is our firm conviction that the nation's unemployment insurance system should provide temporary income support to jobless workers. Other programs targeted at displaced or dislocated workers are needed but they should be funded separately. We are opposed to the diversion of UI trust fund money or UI taxes to programs unrelated to that goal.

We stand ready and look forward to working with this Committee to eliminate the inequities and shortcomings of the present unemployment insurance system.

Thank you.

Statements Adopted by the AFL-CIO Executive Council

Bal Harbour, Florida
February 17-21, 1986

Fact Sheet on Unemployment Compensation

Overview

The nation's unemployment insurance system, established 50 years ago last August, is in a state of crisis. The vast majority of the jobless are not being provided benefits; the long-term unemployed are totally unprotected; employers have successfully convinced legislators to keep taxes low, benefits low and eligibility requirements high; and the Reagan Administration has taken actions and proposed further steps that will make the system more restrictive and less responsive to those in our society who are most in need of protection from the ravages of unemployment.

Priority Issues

1. *Decline in percentage of unemployed receiving benefits.* At the present time, nearly 7 out of every 10 of the jobless are receiving nothing from the nation's unemployment compensation system. In October 1985, only 26.6 percent of the unemployed received benefits, an all-time low. In 1975, an average of 76 percent of the unemployed received benefits.

2. *Long-term jobless have lost virtually all protection.* Today only 1 percent of those unemployed for 27 weeks or longer qualify for extended benefits (UC benefits beyond the normal 26 weeks of benefits provided by the states). Due to changes brought about by the Reagan Administration in the trigger mechanism, only the state of Alaska and Puerto Rico currently qualify for the federal/state extended benefit program (up to 13 weeks of benefits beyond the regular benefit program operated by the state).

3. *Benefit levels are low.* In 1985, the average weekly benefit amount in the United States was $122. This represents 35 percent of the average weekly wage in covered employment ($347).

4. *Employer taxes have declined.* The ratio of wages subject to UI taxes was 98 percent in 1939 while today it is 36 percent. This is one of the most regressive of all taxes. The federal taxable wage base has been changed only 4 times. Originally all covered wages were subject to the Federal Unemployment Tax Act (FUTA). In 1940, the FUTA tax was limited to the first $3,000. Forty-six years later, in 1986, it is only $7,000. The result has been chronic serious underfinancing of the system.

5. *Further cuts planned.* New efforts being undertaken by the Reagan Administration, under the guise of quality control, shifting administrative costs to the states, and more onerous experience rating, can only encourage the states to adopt more restrictions on eligibility and harsher disqualifications, and impose more reductions and lower limits on benefit levels.

Crisis in the Unemployment Insurance System

A. Inadequacy of Coverage

On average in 1984, just under 3 million of the over 8½ million unemployed received UI benefits under the state regular benefit program and the federal/state programs for the long-term unemployed. Only 34.1 percent of the jobless got benefits—65.9 percent fell through the cracks. They either failed to meet qualification requirements or had previously exhausted benefits.

The record for 1985 is far worse. During five months in 1985 (June through October), less than 30 percent of the unemployed received benefits under all UI programs. Overall in 1985, just 33.6 percent of the unemployed got compensation from the system. This meant that during each month of the year more than 5¼ million of the jobless received nothing.

For the long-term jobless, there is no protection afforded by the present system. There have been well in excess of 1 million long-term jobless (27 weeks or more) during every month of 1985. This does not include the discouraged or those working part-time but needing full-time employment. Ninety-nine percent of those out of work six months or longer get nothing from the UI system.

In a 1985 report for the National Governor's Association, Wayne Vroman of the Urban Institute concluded that "although there have been widespread cutbacks in UI benefits, the largest reductions that have taken place have been in benefits paid to the long-term unemployed. Sharp cutbacks in long-term UI benefits have occurred despite the fact that long-term unemployment was more prevalent in 1982, 1983 and 1984 than in any other years since World War II."

As recently as 1975, over 76 percent of the unemployed were receiving benefits from either the regular program or one of the programs established to assist the long-term jobless. Although there were fewer long-term unemployed in the mid 1970s, extended benefits were being paid to an average of 535,000 each week. Today, only 12,000 of the long-term jobless qualify for such assistance (limited to those in Alaska and Puerto Rico).

According to Gary Burtless of the Brookings Institution, "some critics of unemployment insurance might fault the comparison with 1975-76 because benefits in that period were unusually generous, lasting up to 65 weeks irrespective of a worker's financial need. However, even in comparison to earlier recessions when unemployment insurance was less generous, benefits provided in 1981-82 covered an unusually small fraction of the unemployed. Except during the comparatively mild recession in 1970-71, at least 56 percent of the unemployed received jobless benefits in every postwar recession through 1977."

Burtless also points out the declining value of the nation's UI system as a countercyclical stimulus. He notes that "in fiscal 1976, when only 7.6 million were unemployed, the nation spent almost $31 billion (1982 dollars) on all unemployment insurance programs. (In 1982), when unemployment averaged 10 million, less than $24 billion was spent on these programs. Thus the amount of countercyclical stimulus dropped by nearly one-fourth though the number of unemployed was higher by one-third. The real compensation per unemployed worker fell by over 40 percent."

Problems: Restrictions and Underfunding

B. Restrictions

1. Beginning in 1979 (The Revenue Act of 1978), UI benefits became taxable as ordinary income at certain levels ($20,000 for singles and $25,000 for couples filing jointly). P.L. 97-248 lowered those levels to $12,000 for singles and $18,000 for married individuals in 1982. The current tax bill being considered in Congress would tax all UI benefits. Subjecting UI benefits to taxation established a precedent for taxing government transfer payments previously always treated as non-taxable income.

2. Due to proposals of the Reagan Administration that were adopted in the Omnibus Budget Reconciliation Act of 1981, a number of far-reaching changes were implemented that have sharply modified the scope of UI and have severely restricted eligibility of the long-term unemployed.

a.) Access to extended benefits was curtailed by eliminating the national trigger, excluding EB recipients from trigger computations and raising the levels of the automatic and optional state triggers. These restrictions are so tight that today only a handful of jobless workers in Puerto Rico and Alaska are receiving extended benefits. Additionally, the failure of the Administration and Congress last March to extend the Federal Supplemental Compensation program (FSC) resulted in the loss of benefits to over 340,000 long-term jobless workers.

b.) The cost of indebtedness to states forced to borrow from the federal government was raised by imposing interest charges on loans made after March 31, 1982. Hence during recessions and periods of high unemployment, states are faced with the choice of incurring additional debt through interest charges or avoiding that debt by reducing benefit levels and periods of durations and making eligibility requirements more strict. States were further encouraged to make their systems more restrictive by the Social Security Amendments of 1983. If a debtor state improved its solvency by 25 percent through tax increases or benefit reductions, it was allowed to defer, at no cost, 80 percent of the interest payments on federal loans. Additional incentives were available to those states making solvency adjustments greater than 25 percent by reducing interest rates and federal unemployment tax (FUT) penalties. By March 1984, all eight of the largest debtor states had enacted solvency legislation (PA, IL, OH, WI, MI, TX, LA and NJ).

Wayne Vroman has estimated that program solvency will be improved in those states by $12 billion in the 1983-86 period. Tax increases would account for $8.3 billion or 69 percent of the total and benefit reductions would account for $3.7 billion or 31 percent. But due to savings on interest deferral, lower interest rates and reduced FUT penalties, the net increase in employer UI costs would be $5.4

billion making the employer/employee share of the net change in these eight states 59 percent and 41 percent respectively. The types of benefit reductions include: a freeze on benefit maximums, reduction in the replacement rate (i.e., the ratio of benefits to previous wages), reducing duration periods, and increasing base period earning requirements. Although Vroman examined only these eight states, similar actions were taken by other debtor states and states attempting to avoid debtor status.

c.) Workers' access to benefits under the Trade Adjustment Assistance (TAA) program was sharply reduced.

d.) The availability of UI benefits for those leaving military service was curtailed.

3. In the past year, the Reagan Administration has acted or has proposed actions which can only result in a more restrictive unemployment insurance program.

a.) The Department of Labor had planned to implement last July a so-called "Quality Control System" which would have required each state to audit up to 1,600 UI benefit recipients each year. Secretary Brock, at the request of the AFL-CIO, delayed the scheduled implementation of the program. As originally planned, the QC program would have fulfilled demands by the Chamber of Commerce and other business groups to examine what are claimed to be instances of overpayments due in most cases to the failure of claimants to meet work-search requirements. Most state work-search requirements, particularly during periods of high joblessness, are a form of harassment to the unemployed and constitute a nuisance to employers. The AFL-CIO insisted that any "quality control" program should include audits of denials, which would reveal significant cases of underpayments, as well as audits of tax collections which would reveal non-payment and late payment of taxes by employers. Such tax delinquencies, according to a Department of Labor analysis of 1982 figures, amount to nearly $1 billion a year. The Secretary announced in December that the Department would proceed with the QC program in March 1986. It will focus first on overpayments and only at some unspecified date will it eventually "be expanded to include the investigation of claims that had been denied and employer tax collection activities."

b.) For the past several years, the Office of Management and Budget has been promoting a scheme called "devolution." Under this proposal, the responsibility for funding state administrative expenses in the UI system would be transferred from the federal government to the states. Since the inception of the nation's unemployment insurance program over 50 years ago, administrative costs at both the federal level and the state level have been funded by the federal government from funds collected through the Federal Unemployment Tax (FUT). Under devolution, states would be forced either to raise taxes or reduce benefits in order to provide sufficient resources for administrative expenses. Devolution would significantly weaken the federal role in the nation's UI system, making it difficult if not impossible to move toward fair and equitable federal standards. In December, the Department of Labor initiated a period of study and review of "needed changes in the State Employment Security Agency administrative financing system." If devolution emerges from this process, it could have extremely negative and long-lasting effects on the unemployed and on the employees in state agencies, many of whom are union members.

c.) The AFL-CIO has always argued against experience rating as an element in calculating unemployment insurance taxes. Under experience rating, employers with favorable layoff experience in relation to payrolls qualify for lower tax rates than those with less favorable experience. Employers are encouraged by the incentive of experience rating to contest claims by their former employees for unemployment compensation no matter how legitimate those claims may be. The United States is the only country in the world with this feature in its UI program. Short of abolishing experience rating, its effects can only be mitigated by strengthening claimant rights. The Department of Labor's Office of Inspector General, in a report issued last August, has concluded that the unemployment insurance program is becoming more "socialized" due to a decline in the effectiveness of experience rating. The recommendation of the OIG is that policy makers should reverse the alleged decline of experience rating to provide increased incentives for employers to monitor UI benefit claims. In other words, tax rates can be lowered if employers file more appeals and reduce the number of unemployed who are judged eligible for UI benefits. At a time when the nation is failing to provide protection to vast numbers of the unemployed, it is unconscionable for the Department of Labor to propose tighter experience rating measures that can only result in even larger numbers of the jobless being denied UI compensation.

C. Underfunding

The taxable wage base established by the federal government is $7,000. The ratio of wages subject to UI taxes was 98 percent in 1939. Today it is a mere 36 percent. Underfunding has become the rationale for curtailing benefits.

Due to the demands placed on state trust funds by the recessions of 1975-76 and 1980-84 and the failure of policy makers to address the underfunded UI system, inadequate reserves are likely to persist for the foreseeable future. According to Dr. Vroman, "even under an optimistic projection made at the U.S. Department of Labor, total net reserves accumulated through the end of fiscal year 1989 ($32.1 billion) will attain only half of the level recommended as minimally adequate under a commonly used actuarial guideline." (This assumes no additional recessions and continuing restrictiveness on questions of eligibility and benefit levels.)

The formula is simple: keep the system underfunded in relation to the needs; then use the underfunding as the rationale for cutting benefits. The goal: keep inadequate outlays in balance with inadequate revenues.

AFL-CIO Position

As reiterated at the Sixteenth Convention of the AFL-CIO in October 1985, the Federation has called on Congress to restore the nation's unemployment insurance system to a bulwark of protection for all jobless Americans. This would require, at the minimum, the following actions:

- improve the funding of the program by indexing the taxable wage base to at least 65 percent of the average annual wage;
- remove harsh eligibility and disqualification provisions;
- provide jobless aid to the long-term unemployed;
- establish federal minimum benefit standards;
- remove from the tax bill provisions that would subject unemployment insurance benefits to taxation;
- defeat any efforts by the Administration to transfer to the states, through so-called devolution, the responsibility for funding the administrative costs of the nation's unemployment insurance system.

Percentage of jobless receiving UC benefits

Year	Percentage
1975	76%
1976	67
1977	56
1978	43
1979	42
1980	50
1981	41
1982	45
1983	44
1984	34
1985	33.6

Percent of long-term unemployed receiving benefits

	Total unemployed (July) 27 weeks or more	
1980	889,000	33.9%
1983	2,636,000	36.7%
1984	1,608,000	21.3%
1985 (Dec.)	1,145,000	1.1%

Federal Taxable Wage Base

1935	All covered wages and salaries
1940	$3,000
1972	$4,200
1978	$6,000
1983	$7,000

Federal Taxable Wage Base

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State Taxable Wage Base, 1986

Alabama	$ 8,000	Montana	$12,200
Alaska	21,600	Nebraska	7,000
Arizona	7,000	Nevada	11,400
Arkansas	7,500	New Hampshire	7,000
California	7,000	New Jersey	10,700
Colorado	8,000	New Mexico	10,300
Connecticut	7,100	New York	7,000
Delaware	8,250	North Carolina	9,200
District of Columbia	8,000	North Dakota	10,800
Florida	7,000	Ohio	8,000
Georgia	7,500	Oklahoma	8,900
Hawaii	15,600	Oregon	14,000
Idaho	15,600	Pennsylvania	8,000
Illinois	8,500	Puerto Rico	7,000
Indiana	7,000	Rhode Island	11,000
Iowa	12,000	South Carolina	7,000
Kansas	8,000	South Dakota	7,000
Kentucky	8,000	Tennessee	7,000
Louisiana	7,000	Texas	7,000
Maine	7,000	Utah	12,600
Maryland	7,000	Vermont	8,000
Massachusetts	7,000	Virginia	7,000
Michigan	9,500	Washington	11,500
Minnesota	10,700	West Virginia	8,000
Mississippi	7,000	Wisconsin	10,500
Missouri	8,000	Wyoming	9,900

Note: The Federal Unemployment Tax (FUT) is levied on the first $7,000 of earnings. This collection is used to fund the administrative expenses of the system at both the state and the federal level. It is also used to pay the federal share of extended benefits and to advance loans to states whose trust funds have been depleted. 34 states have adopted a taxable wage base above $7,000. Collections from this tax are deposited in the state trust fund account and can only be used to pay regular benefits.

Statements Adopted by the AFL-CIO Executive Council

Bal Harbour, Florida
February 16-20, 1987

Fact Sheet on The Continuing Crisis in Unemployment Insurance

Two-thirds of the jobless are going without unemployment compensation; for all intents and purposes, the long-term unemployed (those out of work for 27 weeks or more) are unprotected by the extended benefit program—the permanent program designed to assist the long-term jobless; the value of unemployment compensation has declined as a percentage of the average weekly wage every year since 1981; and the nation's UI system is playing a smaller role as an automatic stabilizer for the economy during periods of high unemployment.

The nation's UI system has been deliberately underfunded, providing the rationale for policy makers and administrators to restrict and curtail benefits. The recessions of the late 1970s and early 1980s resulted in demands for regular and extended benefits that depleted or exhausted reserves in the trust funds. The federal taxable wage base, as a ratio of wages subject to UI taxes, has declined precipitously since 1939.

1. Uncompensated unemployment

The percentage of the jobless receiving unemployment compensation has declined each year since 1980. In 1975, an average of 76 percent of the unemployed were receiving benefits. In 1986, just one-third were receiving benefits under the regular benefit program, and six states were providing UI benefits to fewer than one-fifth of their jobless. The state of Virginia was compensating a mere 13.3 percent of the unemployed despite reserves in the state benefit trust fund in excess of $485 million.

2. No protection for the long-term unemployed

With the expiration of the Federal Supplemental Compensation (FSC) program in March 1985, the Extended Benefit (EB) program became the only source of jobless aid for the long-term unemployed. Ninety-eight percent of those out of work for six months or longer, regardless of the length of their attachment to the labor force, fail to qualify for this assistance due to changes brought about by the Reagan Administration in 1981. What made this action particularly cruel was that it was implemented in the midst of a recession.

3. The value of UI benefits continues to decline

The National Commission on Unemployment Compensation, in its report to the President and to the Congress in 1980, concluded that one of the goals of the UI system was to ensure that benefits be related to prior earnings and that each state "provide a weekly benefit amount between the minimum and maximum weekly benefit which averages at least 50 percent of the individual's average weekly wage . . . ." In 1982, the average weekly benefit was just 38 percent of the average weekly wage. It has continued to decline over the past four years. In 1986, the replacement rate was 35 percent of the average weekly wage.

4. Countercyclical stimulus weakened

Another objective of the UI system is the countercyclical stimulus that UI dollars have in the economy. The temporary and partial income support paid to jobless workers acts as a stabilizing influence during periods of high unemployment as those funds reenter the local economy. According to Wayne Vroman of the Urban Institute "recent UI benefit payments have been unusually low relative to payments in prior recessions, (and) the program now plays a smaller role as an automatic stabilizer." Gary Burtless of The Brookings Institution noted that "in fiscal 1976, when only 7.6 million were unemployed, the nation spent almost $31 billion (1982 dollars) on all unemployment insurance programs. (In 1982), when unemployment averaged 10 million, less than $24 billion was spent on these programs. Thus the amount of countercyclical stimulus dropped by nearly one-fourth though the number of unemployed was higher by one-third. The real compensation per unemployed worker fell by over 40 percent." In 1985, when unemployment averaged 8.3 million, just $15 billion was spent on these programs, less than half of the 1976 level.

5. Employer taxes have declined

The ratio of wages subject to UI taxes was 98 percent in 1939 while today it is just 36 percent. Because of experience rating which UI law requires in all jurisdictions except Puerto Rico and the excessively low taxable wage base, this is one of the most regressive of all taxes. The federal taxable wage base has been changed only four times. Originally all covered wages were subject to the Federal Unemployment Tax Act (FUTA). In 1940, the FUTA tax was limited to the first $3,000 of wages. Forty-seven years later, in 1987, it is only $7,000. The result has been chronic serious underfinancing of the system.

Developments leading to the crisis in unemployment insurance

A. Underfunding benefit trust funds

Perhaps the single largest problem with the UI system is that it has been seriously underfunded. By keeping the system underfunded in relation to needs, the shortage then becomes the rationale for restricting and cutting benefits. High unemployment since the early 1970s, coupled with the failure of the Congress to adjust the federal taxable wage base, forced 40 of the 53 UI jurisdictions to borrow from the federal government in order to meet obligations to the unemployed.

In the midst of the recessionary economic environment of the early 1980s, the Reagan Administration pushed through the Congress a number of changes which have resulted in the denial of benefits to many of the jobless and a failure to adequately adjust the taxable wage base to ensure that the trust funds are sufficient to meet the demands of the next economic downturn. These actions included:

1. Charging the states interest on all loans made after March 31, 1982;
2. Drastically reducing access to extended benefits by eliminating the national trigger, excluding EB recipients from trigger computations and raising the levels of the automatic and optional state triggers;
3. Permitting debt-related costs on federal loans to be reduced or deferred if "solvency" efforts are made.

B. Imposition of Restrictions

Instead of acting to provide adequate funds to meet the demand, policy makers at both the federal and state level instituted actions to restrict benefit eligibility. According to Gary Burtless and Daniel Saks of The Brookings Institution, in a study done in 1984, some of the most important changes in federal and state practices were motivated by a desire to reduce UI outlays and included the following:

1. More vigorous enforcement of the artificial work search requirement;
2. Elimination of filing UI claims by mail and requiring in-person visits to the UI office;
3. Elimination of UI benefit awards to unemployed workers receiving pensions or social security payments;
4. More stringent provisions resulting in disqualifications or denial of benefits for good cause quits, discharge for misconduct, or failure to "search actively" for work;
5. Lengthening disqualification periods for infractions of procedures and provisions of state law;
6. Taxation of UI benefits;
7. A change in the EB work search requirements to force claimants to accept virtually any minimum wage job; and
8. Imposition by more states of a waiting week for regular UI benefits.

C. Underfunding the administration of the program

As with the benefit trust funds, the federal trust funds financed through the FUTA tax have been underfunded in relation to needs. The FUTA tax funds three accounts: 1) the Employment Security Administration Account (ESAA), which funds administration; 2) the Extended Unemployment Compensation Account (EUCA), which funds the federal share (50 percent) of the extended benefit program, and 3) the Federal Unemployment Account (FUA), which funds loans to insolvent state benefit trust funds.

Although there have been more than adequate amounts accumulated in the ESAA account to fund the administrative expenses of the state UI programs, the Reagan Administration has consistently requested from the Congress insufficient funds in relation to needs. This intentional underfunding of the administration of the UI system has encouraged some states to endorse the Reagan Administration proposals for "devolution" or a defederalization of the funding of the UI and Employment Service Programs. The AFL-CIO is opposed to this effort to shift to the states the financial responsibilities of the Unemployment Insurance and Job Service programs. Such a scheme would require fiscally strapped states either to raise taxes or cut back services in these programs, making individual states responsible for the employment consequences of federal tax and expenditure policies. "Devolution" may also lead to the contracting out of state job service programs.

Adding to this problem was the decision by the Congress to cut appropriations for the administration of the UI program by $144 million

for FY 87. Even though the amount being collected is adequate to fund state UI programs, the amount being appropriated is shrinking due to the inclusion of the ESAA trust fund in the federal unified budget. This encourages the Congress to use the ESAA "surplus" as an offset to the overall federal deficit despite the fact that these funds cannot be used for any purpose other than the administration of the UI program.

The two other federal accounts funded by the FUTA tax remain in debt. Due to earlier heavy demands on the extended benefit account (EUCA) and loans from the federal government (FUA) to insolvent state benefit trust funds as a result of economic downturns in the mid 1970s and early 1980s, the Reagan Administration chose to change the criteria for EB eligibility and encouraged states to restrict payment of regular benefits as indicated above. Rather than adopt the recommendation of the National Commission on Unemployment Compensation to shore up UI funding by increasing the federal taxable wage base, the Reagan Administration has pursued actions that have resulted in the lowest percentage of the jobless receiving unemployment benefits in the history of the UI program.

Elements for reform

1. Improve the funding of the nation's unemployment insurance system by indexing the federal taxable wage base to at least 65 percent of the average annual wage as recommended by the National Commission in 1980. This increase could be phased in over a period of time as suggested by the Commission.
2. Reform the criteria for eligibility for extended benefits. Triggers should be eliminated. Eligibility for EB could be better targeted by linking it to length of attachment to the labor force, earned credits or other factors leading to long-term joblessness. If triggers must be used, the only understandable and appropriate measure is the total unemployment rate (TUR). The insured unemployment rate (IUR) does not accurately reflect economic reality between jurisdictions or within states.
3. Remove the UI trust funds from the federal unified budget. Unemployment insurance taxes and the federal unemployment tax are dedicated funds that are held in trust for benefit payments and for administrative expenses. These funds, to the extent there are positive balances, act to offset the federal budget deficit. In a perverse sense, these positive balances encourage policy makers to pursue actions detrimental to the interests of both unemployed workers and employers who pay taxes into the system. The recent cut by the Congress in appropriations for UI administration, despite the fact that sufficient funds for that purpose have been collected and are available, can be directly attributed to the inclusion of benefit trust funds and administrative trust funds in the unified budget. As with the Social Security trust fund, Congress should act to remove the UI accounts from the federal budget.
4. Eliminate the numerous federal standards that have weakened protection for the unemployed. Some of these include:

   a) the standard requiring pension deduction;
   b) the standard requiring states to deny benefits to non-professional school employees between terms;
   c) the standard prohibiting payment of benefits to certain aliens;
   d) the restrictive standards for extended benefit recipients.

5. Establish federal minimum benefit standards to ensure equal treatment for jobless workers. Such standards should include:
   a) a weekly benefit amount equal to at least 50 percent of the claimant's average weekly wage;
   b) a maximum weekly benefit amount equal to at least 66⅔ of the state's average weekly wage;
   c) a qualifying requirement of not more than 20 weeks of work or the equivalent in earnings during the prior base period;
   d) a maximum of at least 26 weeks duration of weekly benefits payable for claimants meeting such requirements;
   e) a maximum of six weeks suspension of benefits for disqualifications for most causes, with no reduction or cancellation of benefit rights;
   f) a prohibition against the reduction of UI benefits by Social Security, separation, severance or termination pay.
6. Improve federal standards concerning denial of benefits to eligible claimants and provisions for fair hearings.
7. Remove current disqualifications of jobless workers from receiving UI while undergoing training.
8. Similarly, benefits under the Railroad Unemployment Insurance System should be improved as recommended three years ago by the tripartite Railroad Unemployment Compensation Committee (RUC). The RUC, established by law, reported to Congress in 1984 on the need for an increase in the daily benefit rate for unemployed railroad workers. The benefit amount for these jobless workers, $25 per day, has not been raised for nearly 11 years. Rail labor supports the separate railroad unemployment system and calls on Congress for the long-overdue implementation of the RUC recommendations for benefit improvements.

17th AFL-CIO Convention
Resolution on Unemployment Insurance
October 1987

Unemployment insurance in the United States is failing to provide benefits to nearly seven of every ten of the jobless. Hundreds of communities throughout the nation, devastated by continuing high levels of unemployment, are denied the countercyclical stimulation that the system is supposed to provide. Employer taxes have declined as have the value of benefits paid to those jobless workers fortunate enough to qualify under the increasingly restrictive system.

The crisis in the unemployment insurance system, especially the nearly nonexistent extended benefits for the long-term jobless, is a direct result of policies pursued by the Reagan Administration. The deepest cuts have come in the last six years. At both the state and federal level, changes have been made in the system to restrict eligibility for many claimants, reduce benefits for others, and disqualify as many workers as possible from receiving any unemployment insurance benefits.

The principal goal of the unemployment insurance system is to provide temporary income support to the jobless. We oppose proposals to divert existing unemployment insurance trust funds or taxes for programs unrelated to that goal. Programs targeted at displaced or dislocated workers are urgently needed but should be funded separately.

The AFL-CIO is opposed to proposals to "devolve" or defederalize the funding of the costs of administering unemployment insurance and job service programs. The pooling of resources for administrative purposes provides the foundation for unemployment insurance as a basic social insurance system.

We are opposed to the Department of Labor's imposition of a quality control program that only examines recipients of benefits but does not yet include audits of denial of benefits and employer tax collections.

The AFL-CIO calls on the Congress to enact unemployment insurance reforms that will remove the inequities of the current system. These reforms should include improving the funding of the unemployment insurance program by indexing the federal taxable wage base to at least 65 percent of the average annual wage, establishment of federal minimum benefit standards to ensure fair treatment for all jobless workers as well as the repeal of federal mandates requiring the states to deny unemployment benefits to school employees between academic terms or years. All of these measures were recommended by the National Commission on Unemployment Compensation in 1980.

We believe that Congress should reform the criteria for eligibility and ease the qualification requirements for extended benefits. All long-term jobless workers with a demonstrated attachment to the labor force should be entitled to unemployment benefits regardless of the unemployment rate in their state. Therefore, we urge removal of triggers for determination of availability of extended benefits.

We urge enactment of state legislation to assure that workers are adequately represented when their unemployment insurance claims are challenged.

The AFL-CIO urges Congress to resolve the problems of administrative financing of the unemployment insurance system by removing all unemployment insurance trust funds from the federal unified budget. Such action is vital for the integrity of the system and essential to the goal of providing equal justice and treatment to the unemployed regardless of where they happen to live or work.

We believe it is wrong to tax unemployment benefits, and the pre-1979 exclusion for such benefits should be re-enacted.

We also urge the Congress to improve benefits under the Railroad Unemployment Insurance System as recommended three years ago in a report to Congress by the tripartite Railroad Unemployment Compensation Committee.

Mr. PEASE. Thank you, Mr. Ellenberger.
Next, we will hear from Mr. Levinson.

STATEMENT OF MARK LEVINSON, RESEARCH ASSOCIATE, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW, ACCOMPANIED BY JESS DAMESWORTH, UNEMPLOYMENT INSURANCE DEPARTMENT

Mr. LEVINSON. Mr. Chairman, my name is Mark Levinson. I am an economist in the UAW research department. I hope you will not hold that against me, given your comments at the last session.

With me is Jess Damesworth, coordinator of the UAW unemployment insurance department. We thank you for the opportunity to share the views of the UA with you today.

In November of 1987, over 7 million workers were officially counted as unemployed. Another 5½ million people wanted full time work, but only found part time employment.

And an additional 1 million discouraged workers dropped out of the labor force.

The outlook is worrisome. The stock market crash is expected to slow the economy down, and many economists expect a recession by at least early 1989.

So while millions are currently unemployed, the number is likely to grow.

In my short statement—and I have submitted a longer, more detailed statement for the record—in my short statement, I will mention the problems confronting the unemployment insurance system, and comment briefly on the pending legislation.

Not only have unemployment levels been high, but the average length of unemployment has increased. This fact, combined with tightened eligibility requirements and Federal and State budget cuts, have resulted in a dramatic decline in the percent of jobless workers receiving unemployment insurance.

Each month in 1986 more than 5½ million unemployed workers went without any assistance. In October 1987, the percentage of unemployed receiving UI benefits hit a record low 25.4 percent.

In other words, too few workers are receiving UI benefits.

This is related to the second problem in the UI system: underfunding. In 1939, 98 percent of wages were subject to unemployment insurance taxes. Today, it is just 36 percent.

Underfunding the UI system keeps benefits low and provides the rationale against attempts to expand the system.

When great demands are placed on the system, States must either go into debt to pay benefits, or restrict access to benefits.

Another option, raising sufficient revenues to provide protection for the unemployed, is not pursued because it destroys the rationale for curtailing benefits.

The third problem is that since 1981, an increasing amount of employer FUTA taxes, collected to pay for State administration of unemployment insurance programs, has been retained in the Federal trust funds, rather than being appropriated by Congress for use by State agencies.

State agency layoffs and office closings in many States have reduced services to the unemployed.

Some States have been forced to spend State tax dollars to administer their unemployment insurance programs, an unprecedented step in the 50-year history of unemployment insurance.

In Michigan, for example, in March, 1980, there were 4,000 employees at unemployment offices. In 1987, there were only 1,500.

As recently as 1984, there were 110 unemployment offices in Michigan. Now there are only 64.

Much the same has happened in other States.

If Congress wishes to assist the unemployed in finding jobs, and ensuring the prompt payment of benefits, it should stop retaining FUTA funds in the Federal administrative trust fund and give State agencies adequate funds to run their unemployment insurance programs.

The fourth program in our UI system is that weekly benefit amounts have lagged further and further behind the average wage.

And as was pointed out in the last panel, the situation was made worse when the Tax Reform Act of 1986 mandated that unemployment insurance benefits be fully taxed.

I will now comment briefly on H.R. 2676 and H.R. 3213.

H.R. 2676 is a step toward needed reform of the extended benefits program. H.R. 2676 would, among other things, lower the trigger needed to be eligible for extended benefits. It would create a tier of scheduled benefits based on a State's unemployment level of up to 30 weeks of additional payments to the long term jobless.

We support these positive features of H.R. 2676. However, the improvements in maximum duration of extended benefits, we believe, do not go far enough.

The levels of unemployment required to trigger extended benefits continue to be too high.

H.R. 2676 would also authorize several demonstration projects in which the jobless could use unemployment compensation funds to start their own businesses.

It is our judgment that this is not a good idea, nor a meaningful option for the unemployed.

As was pointed out in the last panel, and we agree, the amount of money provided to unemployed workers is far below what is needed to start almost all businesses.

Furthermore, small firms have a particularly high rate of failure. And the chances of developing a small business would be rare during recessions, when the jobless need help the most.

We should also ask what would happen to these people when or if their business fail. They would not be eligible for UI. The failure rate is high. The person would probably be forced onto welfare.

The Government, in effect, ends up paying twice. They pay the UI and the welfare benefits.

Although with the exception just noted, we support H.R. 2676 as far as it goes, protection for the millions of unemployed workers currently without benefits will require more comprehensive reform.

H.R. 3213 would establish demonstration projects in at least five States that would identify dislocated workers early in their period

of unemployment, and provide them with services to assist them in finding new employment.

The UAW strongly supports the goal of assisting unemployed workers in finding jobs, but we do not agree with all of the means proposed in H.R. 3213.

I have already mentioned our opposition to self employment allowances. Nor do we believe that training vouchers are a suitable alternative to sound public funding of training programs.

We are concerned about reemployment bonuses, because we question whether it is wise public policy to provide incentives for workers to take unsuitable work.

More fundamentally, at a time when so few of the unemployed are receiving benefits, and when the unemployment insurance system is drastically underfunded, we are skeptical about proposals to use the unemployment insurance trust fund for purposes beyond what exists in current law, income support for the unemployed.

In conclusion, while we support some of these proposals, we do not think that they address the most important problems facing the unemployment compensation system.

The problems that should be addressed are the low percentage of unemployed workers receiving benefits; deliberate underfunding of the system; inadequate administrative financing; and the low level of income replacement.

Thank you, and we would be glad to answer any questions you might have.

[The statement of Mr. Levinson follows:]

STATEMENT OF
MARK LEVINSON, RESEARCH ASSOCIATE
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE
AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

before the

HOUSE WAYS AND MEANS
SUBCOMMITTEE ON
PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION

HEARING ON REFORM OF THE
UNEMPLOYMENT COMPENSATION PROGRAM

December 14, 1987

Mr. Chairman, my name is Mark Levinson, I am a research associate on the staff of the UAW's Research Department. We appreciate this opportunity to share with you the UAW's views on the condition of existing unemployment compensation programs and how they should be reformed.

The UAW commends you, Mr. Chairman and Members of the Subcommittee for holding this hearing and for considering legislation so desperately needed by millions of unemployed workers and their families. It is gratifying that Members of Congress are focusing upon the economic hardships faced by millions of workers who have lost their jobs through no fault of their own.

Workers deserve adequate and comprehensive protection from long term job loss, especially during periods of high unemployment. Unfortunately, the unemployment compensation system has not been providing adequate protection to the nation's long-term unemployed, especially since the debilitating cutbacks enacted in 1981. The Congress should not allow this shameful condition to persist.

In November 1987, 7.1 million workers were officially unemployed. Another 5.6 million people wanted full-time work but only found part-time employment and an additional 1 million "discouraged" workers dropped out of the labor force.

In our judgment the outlook is not good. The stock market crash is expected to slow the economy down, and many economists expect a recession by early 1989. So while millions are currently unemployed the number is likely to grow.

The federal-state unemployment insurance system was erected in the mid-1930's in recognition of the enormous costs borne by unemployed workers as a result of economic, political, and social forces over which they have no control. Two major goals were set: first, to cushion workers against economic hardship when they become unemployed; second, to bolster purchasing power when total spending is declining, thereby helping to automatically stabilize a historically cyclical economy. The two goals are closely related -- an adequate level and duration of benefits are required to ease private

hardships and bolster a community's total purchasing power during a period of economic decline and increasing unemployment.

The changes in the unemployment insurance system enacted as part of the Omnibus Budget Reconciliation Act of 1981 seriously weakened the program and its role as a first line of defense against the hardships brought about by rising unemployment. Not only have unemployed workers and their families suffered by the shredding of the already threadbare safety net provided by the unemployment insurance program, but employers and their businesses, the communities in which the unemployed live and ultimately the entire economy is hurt by the shrinkage of the unemployment insurance system. The costs arising from unemployment and the exhaustion of benefits are being borne privately in the homes of the unemployed -- private costs that range from financial insolvency and the inability to pay for urgently needed medical care to the rise in intra-family tensions and health care problems. The costs also are being borne socially as the long term impacts of additional welfare costs, higher crime, community instability, and mental health problems associated with increasing unemployment begin to spread.

Too Few Workers Receive Benefits

Recession, import penetration and technological change have all taken a severe toll on jobs. In the 1980s structural unemployment (workers who lost jobs and have no recall date) as a percent of total unemployment has increased compared to previous periods. Not only have unemployment levels been high, but the average length of unemployment has increased. The changing nature of unemployment combined with tightened eligibility requirements and budget cuts at the federal and state level have resulted in a dramatic decline in the percent of jobless workers receiving unemployment insurance. The unemployment insurance system now assists only a small fraction of jobless workers. Currently no state qualifies for extended benefits.

The year 1986 was the first since the nation's unemployment insurance system was established 52 years ago that less than one-third of the jobless received benefits. Each month more than 5.5 million unemployed workers went without any assistance. In October 1987, the percentage of unemployed receiving unemployment insurance benefits hit a record low 25.4 percent. This level is only about two-thirds what it was in 1978 when the unemployment rate was at about the same level as today.

Unemployment Insurance Trust Funds Are Underfinanced

In 1939, 98 percent of wages were subject to unemployment insurance taxes. Today it is just 36 percent. Underfunding the unemployment insurance system keeps benefits low and provides the rationale against attempts to expand the system. When great demands are placed on the system during periods of high unemployment -- such as we have experienced throughtout the 1980s -- the states must either go into debt to pay benefits or restrict access to benefits. Another option (resisted by many business interests) -- raising sufficient revenues to provide protection for all our unemployed -- is not pursued because it would destroy the rationale for curtailing benefits.

In a 1985 report for the National Governors Association, Dr. Wayne Vroman states:

> "Even under an optimistic projection made at the U.S. Department of Labor, total net reserves accumulated through the end of fiscal year 1989 (32.1 billion) will attain only half of the level recommended as minimally adequate under a commonly used actuarial guidelines."

Vroman's analysis assumes no recession: the likelihood of an economic downturn between now and 1989 means that the condition of state trust funds -- because of underfinancing -- is precarious at best.

Inadequate Administrative Financing

Since 1981, an increasing amount of employer Federal Unemployment Tax Act (FUTA) taxes collected to pay for state administration of unemployment insurance programs has been retained in the federal trust funds, rather than being appropriated by Congress for use by state agencies. As a result, state agencies have been withering on the vine for lack of administrative funds. State agency layoffs and office closings in many states have reduced services to the unemployed. Some states have been forced to spend state tax dollars to administer their unemployment insurance programs, an unprecedented step in the 50-year history of unemployment insurance.

In Michigan, for example, in March 1980 there were 4,000 employees at unemployment offices. In 1987 there are only 1,500. As recently as 1984 there were 110 unemployment offices in Michigan, now there are only 64. Much the same has happened in many other states.

The result of this severe decline in administrative financing is reduced services to claimants. If Congress wishes to assist the unemployed in finding jobs and insure the prompt payment of benefits, it should stop retaining FUTA funds in the

federal administrative trust fund and give state agencies adequate funds to run their unemployment insurance programs.

Low Proportion of Income Replacement

Weekly benefit amounts have lagged further and further behind the average wage. In 1982 the average weekly unemployment insurance benefit was just 38 percent of the average weekly wage. In 1986 the replacement rate was 35 percent of the average weekly wage. This situation was made worse when the Tax Reform Act of 1986 mandated that unemployment insurance benefits be fully taxed. As a result unemployment today entails greater income loss than in the past, often including a brush with poverty.

Comments on H.R. 2676 and H.R. 3213

H.R. 2676, the proposed Extended Unemployment Insurance Reform Act of 1987, is a step toward needed reform of the Extended Benefits (EB) program. In recent years, the long-term unemployed have been without an effective EB program.

H.R. 2676 would, among other things, lower the trigger needed to be eligible for extended benefits. It would create a tiered schedule of benefits, based on a state's unemployment level, of up to 30 weeks of additional payments to the long-term jobless. The costs of this program would be shared by states and the federal government. The federal share would range from 50 percent to 90 percent depending upon state unemployment rates. We believe this is an equitable approach which would reduce the financial burden on states in which unemployment is high and of long duration and thus enable states to improve rather than cut back benefits for unemployed workers.

The bill also provides for a demonstration project in which the Secretary of Labor would develop criteria that states would use in approving training for individuals receiving unemployment insurance. Current law prohibiting states from disqualifying claimants in approved training has not been effective. Most states have no criteria for approving training while on unemployment compensation.

We support these positive features of H.R. 2676. However, the improvements in maximum duration of extended benefits do not go far enough. Extended Benefits would be available to the long-term jobless only in those states with total unemployment rates of 13 percent or insured unemployment rates of 8 percent, with the additional requirement that the IUR equaled or exceeds 105 percent of the average of such rates for the corresponding 13-week period in each of the preceding 6 years. While the establishment of a program that would expand automatically as unemployment

rose would be an improvement in the current system, the levels of unemployment required to trigger on extended benefits continue to be too high. If a trigger must be used in the extended benefits program, the total unemployment rate (national or state) is the best available measure. If insured unemployment rates must be used, the percentage of the prior six years' insured unemployment for each tier of benefits should be eliminated and recipients of unemployment compensation benefits under all programs should be included in the calculation of the insured unemployment rate.

H.R. 2676 would also authorize several demonstration projects in which the jobless could use unemployment compensation funds to start their own businesses. It is our judgment that this would not be a meaningful option for the unemployed. The average unemployment compensation payment is $129 a week. In 26 weeks, the normal maximum period of unemployment insurance eligibility that would provide just over $3,300, an amount far below what is needed to start almost all businesses. Furthermore, small firms are often very fragile. About 70 percent of firms with less than 20 employees fail within four years. Finally, the chances for developing a small business would be rare during recessions when the jobless need help the most.

Although, with the exception just noted, we support H.R. 2676 as far as it goes, protection of the millions of unemployed workers currently without benefits will require more comprehensive reform.

H.R. 3213, the proposed Unemployment Insurance Reemployment Demonstration Projects Act, would establish demonstration projects in at least five states that would identify dislocated workers early in their period of unemployment and provide them with services to assist them in finding new employment. The demonstration projects would coordinate the Unemployment Insurance, Employment Service and Job Training Partnership Act systems and make available services such as vocational and financial counseling, job search assistance, occupational skill training, on-the-job training vouchers, basic education, relocation assistance, self-employment allowances, reemployment bonuses, economic adjustment allowances and supportive services including transportation and child care.

The UAW strongly supports the goal of assisting unemployed workers in finding jobs, but we do not agree with all of the means proposed in H.R. 3213. I have already explained our opposition to self-employment allowances. We do not believe that training vouchers are a suitable alternative to sound public funding of training programs and we are concerned about reemployment bonuses because we question whether it is wise public policy to provide incentives for workers to take unsuitable work. More fundamentally, at a time when so few of the unemployed are receiving

benefits and when the unemployment insurance system is drastically underfunded we are skeptical about proposals to use the unemployment insurance trust fund for purposes beyond what exists in current law -- income support for the unemployed.

In conclusion, while we support some of these proposals we do not think that they address the most important problems facing the unemployment compensation system.

UAW Recommendations to Improve Unemployment Insurance

-- We urge Congress to adopt a fully adequate Federal-State Extended Benefit program. This would require eliminating the increase in the unemployment rates for individual states to trigger the Extended Benefit program. It would also require rescinding the amendments to the Extended Benefit program which eliminates federal matching funds for states without a waiting week. The national trigger for paying extended benefits in all states when the national insured unemployed rate exceeds 4.5 percent should also be restored. Computation of the insured unemployment rate should not be restricted to claimants receiving regular state benefits, but should also include recipients of extended benefits.

-- Beyond this, we need federal legislation to improve and consolidate programs for the long-term unemployed. Eligible workers should always be entitled to unemployment benefits up to a maximum of at least 52 weeks. When the national unemployment rate exceeds 4 percent benefits should be extended to 65 weeks.

-- We need to increase benefits. Weekly cash unemployment insurance benefits should replace at least two-thirds of the workers' average weekly earnings. Automatic provisions must insure that benefits remain at these levels.

-- The UAW opposes "devolution," and other proposals that give states greater control over unemployment insurance programs. The UAW supports a single federal unemployment insurance program with nationally legislated benefits, standards, and financing. The lack of federal standards causes a competition between states in their efforts to attract business at the expense of unemployed workers. Business exploits this situation by demanding further reductions in unemployment insurance programs leading to the present failure of the unemployment insurance system.

-- The experience rating system should insure that all employers share at least part of the costs of unemployment. A program of cost-equalization and reinsurance, across the states, should be established to reduce the burden on those states experiencing abnormally high costs during a national recession.

-- Taxation of unemployment insurance should be repealed. Federal taxation of unemployment insurance benefits is, in effect, a federally mandated reduction in benefit amounts which only exacerbates the need for increased weekly benefit amounts.

-- Restrictive eligibility provisions should be removed and there should not be any waiting weeks. Harsh work search requirements should not be used to deny benefits to unemployed workers. Restrictions on wages needed to qualify for unemployment insurance benefits should be lowered to increase the percentage of the unemployed receiving compensation. Federal standards should eliminate unfair disqualifications.

-- Financing should be strengthened by raising the current taxable federal unemployment insurance wage base in steps up to the Social Security taxable wage base and by assuring that the unemployment insurance base thereafter keeps pace with the base for Social Security. The federal government should provide adequate administrative financing to state agencies.

-- The unemployment insurance trust funds should be removed from the federal unified budget. These monies are reserved for the payment of unemployment insurance benefits and administrative costs. Their inclusion in the budget for bookkeeping reasons should be stopped.

-- Unemployment insurance should not be reduced by pension income, Social Security, separation, severance or termination pay. We have worked with others to repeal the federal law requiring states to provide for reduction of unemployment insurance by pension income after March 1980.

-- Unemployment insurance should not be denied employees of educational institutions during summer vacations and between terms, simply because their employer has not formally terminated their employment.

-- The Employment Service should be improved and employers should provide it listings of all job openings. Federalization of the Employment Service is long overdue.

-- We urge states to adopt procedures to insure that both claimants and employers received fair hearings on unemployment insurance claims, including adequate time to file appeals with provisions for late filing for good cause and an ombudsman's office to assist claimants and small employers with claims procedures and appeal hearings.

-- The UAW has long called for an overhaul of the unemployment insurance system such as the reforms called for by the National Commission on Unemployment Compensation in 1980, which remain relevant today.

In conclusion, the UAW applauds this subcommittee and you, Mr. Chairman, for holding this hearing. With the likelihood of an economic downturn, strengthening the unemployment insurance system is vital to protect workers, their communities and the entire economy against the debilitating effects of long-term unemployment.

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Mr. PEASE. Thank you very much, Mr. Levinson.
Mr. Hughes.

STATEMENT OF CHARLES HUGHES, CHAIRMAN, SCHOOL EMPLOYEES ADVISORY COMMITTEE, AMERICAN FEDERATION OF STATE, COUNTY & MUNICIPAL EMPLOYEES, AND PRESIDENT OF LOCAL 372, ACCOMPANIED BY CHARLES M. LOVELESS, LEGISLATIVE AFFAIRS SPECIALIST

Mr. HUGHES. Good morning—good afternoon, Mr. Chairman.
Mr. PEASE. It was morning when you expected to testify. [Laughter.]
Mr. HUGHES. It is an honor for me to be here again with my colleagues from the labor movement.
And Mr. Chairman, I am Charles Hughes, and the chairperson of the School Employees Advisory Committee of the American Federation of State, County & Municipal Employees (AFSCME), and I am president of local 372 of the Board of Education, District Council 37, in New York City. Accompanying me today is Charles Loveless of AFSCME's, department of legislation. And we are appearing today on behalf of the more than 1.3 million members of AFSCME who work in State and local governments across the Nation.
We commend the subcommittee for holding this general oversight hearing on the Nation's unemployment compensation system, and for specifically focusing on the question of the adequacy of the coverage and service it provides.
AFSCME counts among its members thousands of people who work in this Nation's unemployment insurance, employment service and welfare systems.
I am not prepared to comment specifically on your bills that you have introduced. However, I can tell you that after 7 years of reduction in funding and restrictions on eligibility, we share the concern that these systems are no longer adequately prepared for a recession. We too think that the extended benefit program ought to be liberalized, and that it ought to be easier for people receiving UI benefits to further their education and training.
We would welcome additional support for early assessment, testing, and counseling of unemployed workers through the ESUI system.
We are concerned, however, that we not rely too heavily on the states or existing UI benefit funds for any expansion of services and benefits. So far, the States have been unwilling and/or unable to make up for Federal reductions in the ESUI. Employment and economic policies are now accepted Federal responsibilities, and should be funded by the Federal Government. I know that AFSCME's legislative staff in Washington looks forward to working with the members of the subcommittees on these bills.
While these and other numerous pressing policy questions will be addressed in this hearing, we want to use our allotted time today to raise an issue of critical concern to the hundreds of thousands of educational support service employees across the Nation. This issue is directly related to the question of the adequacy of coverage provided by the Federal-State Unemployment Insurance System.

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As part of the Social Security rescue package, which was adopted by Congress in 1983, a provision was included requiring the States to deny unemployment benefits between academic years or terms to nonprofessional public school employees if they have reasonable assurance of returning to work in the next academic year.

It should be noted that this automatic blanket denial requirement was added to the Social Security bill without the benefit of normal legislative deliberations. The provision was attached to the Senate version of the Social Security bill during the Finance Committee's consideration of the bill. No hearings have ever been held on that issue, and there was not a comparable provision in the House Social Security bill. This was one of the last issues to be resolved in the House and Senate Conference on the 1983 Social Security Amendments.

As a result of this new Federal mandate, thousands of support service employees of elementary, secondary and higher educational institutions have lost protection against unemployment between academic years or terms. While we have had only limited experience with the new law since it only recently was made effective, we already know that the impact has been devastating for many school workers and their families.

Support service employees—the custodians, cafeteria workers, bus drivers, crossing guards and secretaries who keep our schools running—are among the lowest paid group of workers in the Nation, with many working at or near the minimum wage level.

A recent salary survey conducted by the Educational Research Service clearly indicates the very low level of compensation received by nonprofessional school employees. Many work at wage levels approximating the minimum wage. Typically, such workers are paid on an hourly basis during the 9-month school period.

And if I might just ad lib for one moment, Mr. Chairman, you know it's kind of tough when you don't get anything for 6 to 8 weeks. If you happen to have a loan from HFC or Beneficial Finance Company, you're 3 or 4 months behind. And many of the people who are on the hourly rates have to wait 3 to 4 weeks before they even get a paycheck. And so you can see what it's doing to their budget.

Given the very low hourly rates of compensation, it cannot be reasonably maintained that this wage rate is intended to cover the nonwork period between academic years.

As a matter of basic equity, we do not see why nonprofessional public school employees should be singled out for unequal treatment in the law. And I believe it is unconscionable to deny unemployment benefits between academic years or terms to the lowest paid group of public employees, when other public and private employees performing work which is also characterized by regularly recurring lapses in activity are not denied benefits under this Federal law. With the exception of professional athletes and educational employees, all other major seasonal occupational categories are eligible to apply for unemployment insurance benefits. Certainly, no compelling need has been demonstrated for singling out educational support service employees for unequal treatment.

In conclusion, as you consider proposals to improve the Federal/State Unemployment Insurance System, we strongly urge you to

give serious consideration to repealing the automatic blanket denial requirement relating to the nonprofessional school employees.

We thank you for this opportunity to present our views on this matter of utmost concern to public school workers, and stand ready to answer any questions you may have.

Thank you, Mr. Chairman.

[The statement of Mr. Hughes follows:]

STATEMENT OF CHARLES HUGHES, PRESIDENT, LOCAL 372
AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

Mr. Chairman, and distinguished members of the Subcommittee on Public Assistance and Unemployment Compensation, I am Charles Hughes, Chairman of the School Employees Advisory Committee of the American Federation of State, County and Municipal Employees (AFSCME) and President of Local 372, Board of Education Employees, District Council 37 in New York City. I am accompanied by Charles M. Loveless of AFSCME's Department of Legislation. We are appearing today on behalf of the more than 1.3 million members of AFSCME who work in state and local governments across the nation.

We commend the Subcommittee for holding this general oversight hearing on the Federal-State Unemployment Compensation (UC) System and for specifically focusing on the question of the adequacy of the coverage it provides. While there are numerous pressing policy questions which should be addressed in this hearing, we want to use our allotted time today to raise an issue of critical concern to the hundreds of thousands of nonprofessional school employees across the nation. This issue is directly related to the question of the adequacy of coverage provided by the federal-state unemployment insurance system.

As part of the Social Security rescue package which was adopted by Congress in 1983 a provision was included requiring the states to deny unemployment benefits between academic years or terms to nonprofessional public school employees. As explained in the conference report on the Social Security Amendments of 1983, states are required to deny unemployment insurance benefits between academic years to nonprofessional employees of educational institutions and educational service agencies if the employees have "reasonable assurance" of returning to work in the next academic year. It is optional to the states to extend the between term denial to workers performing services on behalf of an educational institution or an educational service agency even though not employed by either the institution or agency. Prior to the adoption of this amendment, states were permitted to determine whether or not to deny unemployment benefits to such workers.

It should be noted that the automatic blanket denial requirement was added to the Social Security bill without the benefit of normal legislative deliberations. The provision was attached to the Senate version of the Social Security bill by Senator John Chafee during the Finance Committee's consideration of the bill. No hearings were ever held on the issue, and there was not a comparable provision in the House Social Security bill. The Chafee amendment was one of the last provisions to be resolved by the House and Senate conferees on the 1983 Social Security Amendments Act.

As a result of this new provision, many thousands of nonprofessional employees of elementary, secondary and higher education institutions have lost protection against unemployment between academic years or terms. While we have had only limited experience with the law since it was made effective for weeks of unemployment beginning after April 1, 1984, we already know that the impact has been devastating for many school workers and their families. As will be indicated below, nonprofessional school employees are among the lowest paid group of workers in the nation, with many working at or near the minimum wage level. The automatic blanket denial has created a major new financial hardship for thousands of nonprofessional school workers who are

temporarily out of work through no fault of their own. Many of these workers have had to apply for various forms of public assistance to make ends meet.

AFSCME represents approximately 100,000 nonprofessional public school employees across the nation. These employees generally may be placed in two major categories: clerical and service-maintenance. The position titles of AFSCME members include custodians and general maintenance staff, cafeteria workers, bus drivers, school crossing guards, secretaries, clerical personnel, school aides, nurses and nursing aides. Women and minority group members are heavily represented in these positions.

A recent salary survey conducted by the Educational Research Service, Inc. which is set forth below as Attachment "A" clearly indicates the very low level of compensation received by nonprofessional school employees; many work at wage levels approximating the minimum wage. Typically, such workers are paid on an hourly basis during the nine month school period. Given the very low hourly rate of compensation, it cannot be reasonably maintained that this wage rate is intended to cover non-work periods between academic years.

It should come as no surprise that, with certain exceptions, most of these workers do not possess additional vocational skills to qualify for other jobs. Furthermore, many employers refuse to hire those employees who are able to qualify for other positions because they know that such employees can only work for them on a temporary basis. Accordingly, such employees are frequently unable to find other work during the period between school terms, and they thus are in every sense of the word "unemployed."

We believe there are several compelling policy reasons why the automatic blanket denial requirement imposed by the 1983 Social Security Amendments should be eliminated and states should be restored the option whether or not to have special denial provisions relating to nonprofessional school employees. First, as a matter of basic equity, we do not see why nonprofessional public school employees should be singled-out for unequal treatment in the law. In our view, it is unconscionable to deny unemployment benefits between terms to the lowest paid group of public employees when other public and private employees performing work which is also characterized by regularly recurring lapses in activity are not denied such benefits under federal law. With the exception of professional athletes and educational employees, all other major seasonal occupational categories are eligible to apply for unemployment insurance benefits. Certainly, no compelling need has been demonstrated for a federal requirement singling-out this category of workers for unequal treatment.

The fact that the blanket denial requirement does not automatically apply to other groups of employees has led to anomalous results in many states. Some employees who perform educationally related duties but do not directly work for an educational institution or service agency are eligible to receive unemployment benefits between terms while those who are employed directly by the institution and may perform work of an identical nature are not. For example, in the State of Maryland, while many school crossing guards and nurses work for local school

boards, large numbers are employed by other government units, including county police and health departments. The latter group is eligible to receive unemployment benefits between terms while the former is not.

A second major policy reason why the automatic blanket denial requirement should be eliminated is that there already exist adequate mechanisms within the federal-state unemployment compensation system for denying unworthy benefit claims. All unemployment compensation applicants, including nonprofessional school employees, must satisfy the eligibility requirements set forth in state law for receiving such benefits. They must meet availability for work and work search requirements.

Finally, we believe that the automatic blanket denial requirement has served to undermine the basic principles for which the unemployment compensation program was established in the 1930s. As noted in a recent General Accounting Office Report, the objective of the program "...has been to provide temporary protection for qualified workers who lose jobs until they can either be rehired or find new employment." Unfortunately, this basic objective of the program has been seriously compromised by the automatic blanket denial requirement imposed by the Social Security Amendments of 1983. In our view, this requirement mandating unequal treatment of nonprofessional public school workers calls into question the overall institutional integrity of the program.

For the foregoing reasons, AFSCME strongly urges the Subcommittee to give serious consideration to eliminating the automatic blanket denial requirement relating to nonprofessional school employees as it considers proposals to improve the federal-state unemployment insurance system. We thank you for the opportunity to present our views on this matter of utmost concern to public school workers. We stand ready to provide any additional information or assistance which you may require.

Mr. PEASE. Thank you, Mr. Hughes.
Ms. Dix.

STATEMENT OF PAT DIX, LEGISLATIVE SPECIALIST, NATIONAL EDUCATION ASSOCIATION

Ms. DIX. Thank you, Mr. Chairman.

I am Pat Dix, a legislative specialist for the 1.9 million member National Education Association. I appreciate the opportunity to share with you our views on a grave inequity that exists in the current provisions of the Federal-State unemployment compensation system.

The Federal statutes which prohibit States from fully protecting elementary and secondary school employees who have been laid off create an undue hardship on workers and the Nation's public schools.

We urge this subcommittee to take up legislation that would allow States to address the needs of these workers.

NEA members include faculty and staff of the Nation's public elementary, secondary, vocational, and postsecondary schools, including 120,000 education support employees which consists of paraprofessionals, secretarial and clerical employees, business services, technicians, custodians, bus drivers, cafeteria workers, which Mr. Hughes has already mentioned.

The treatment of school employees under the unemployment compensation system is a gross injustice. The law recognizes the need to provide basic protection for other seasonal employees and for public employees who perform similar work to school employees.

Until 1976, education employees were excluded from unemployment coverage. The supplemental unemployment assistance program extended coverage to employees of State and local governments, but prohibited unemployment benefits for instructional employees of elementary and secondary schools between school terms as long as such workers had contracts or reasonable assurance of employment during the next school term.

The law gave the States the option of providing or denying unemployment benefits to school support employees between terms.

In 1983, this State option was eradicated without benefit of hearings, without an opportunity for those harmed to air their view and concerns, and without a chance for Members of Congress to consider the effects of this change.

These prohibitions eliminate unemployment assistance to many school employees even though they are truly unemployed. Many school districts use this ambiguous language of the law as a way to avoid paying unemployment compensation. Thus, many individuals are ineligible for unemployment, not on the basis of the kind of work they do, but as a function of who signs their checks in local school agency or in municipal, county, or State government.

The mandatory exclusion of education support employees discriminates against a class of workers who play an essential part in the public education enterprise. Education support employees are responsible for maintaining the health and safety conditions of our public schools, and share responsibility for the care and nurture of

America's public school children. Yet, with few exceptions, education support employees are among the lowest paid employees in our society, and the first to be laid off when public schools meet financial difficulties.

The unemployment compensation system gives States broad flexibility over benefits and exclusions. A Federal statute which eliminates the State's option of covering education employees is out of sync with the history and purpose of the system.

There are countless professions where the nature of the industry determines that there are normal periods of the year when individuals in these professions are periodically unemployed. In no case, with the exception of professional athletes, is there a blanket provision declaring the ineligibility for unemployment assistance.

The operative question for these other seasonal employees, as it should be for school employees, is whether they are now unemployed, not whether they may be employed in the future.

There is no compelling need for Federal regulation exempting school employees. Because States have a financial obligation at stake, it is unreasonable to assume that those States would abuse the program. There are sufficient protections, including qualifying eligibility requirements to prevent abuse by individuals.

What we seek is unemployment protection for those who need it, no more and no less than almost all other workers now enjoy. At best, unemployment coverage as under the 1976 Supplemental Unemployment Assistant Program should be restored for all school employees. But, at the very least, States should have the option to provide unemployment assistance to education support employees as they did prior to enactment of the 1983 prohibition.

We urge you to take steps to address this inequity.

Thank you, Mr. Chairman.

[The statement of Ms. Dix follows:]

STATEMENT OF THE NATIONAL EDUCATION ASSOCIATION

Mr. Chairman and Members of the Committee:

I am Pat Dix, a legislative specialist for the 1.9 million-member National Education Association. I appreciate the opportunity to appear before this Subcommittee to share with you our views on a grave inequity that exists in the current provisions of the Federal-State Unemployment Compensation System.

NEA believes that current federal statutes prohibiting states from fully protecting elementary and secondary school employees who have been laid off creates an undue hardship on workers in the nation's public schools. We, therefore, urge this Subcommittee to take up legislation that would allow states to address the needs of these workers, and ultimately the schools as a whole.

NEA members include faculty and staff of the nation's public elementary, secondary, vocational, and postsecondary schools, including 120,000 education support employees: paraprofessionals, secretarial and clerical employees, business services, technicians, custodians, bus drivers, cafeteria workers, and others.

The treatment of school employees under the Unemployment Compensation System is a gross injustice. The law recognizes the need to provide basic protection to other seasonal employees and to other public employees who perform work similar to school employees, and yet many school employees are penalized for no other reason than the fact that they are employed by the public schools.

Although elementary and secondary education employees as a whole are adversely affected by the federal limitations in coverage under the Unemployment Compensation System, NEA is particularly concerned about the adverse impact of changes made in the law in 1983 penalizing education support employees.

Background

From the time the Unemployment Compensation System was established in 1935 until the enactment of the Special Unemployment Assistance (SUA) program — the 1976 amendments to the Federal Unemployment Tax Act — elementary and secondary education employees, like many other public employees, were excluded from unemployment coverage. The 1976 legislation, with some exceptions, extended coverage to employees of state and local governments, but prohibited unemployment benefits for teachers and other professional employees of elementary and secondary schools during vacation periods as long as such workers had contracts or "reasonable assurance" of employment during the next school term. "Reasonable assurance" was defined in SUA as "a written, verbal or implied agreement that the employee will perform services in the same capacity during the ensuing academic year or term." And the SUA program gave states the option of providing or denying unemployment benefits to education support employees.

In 1983, this state option was eradicated by a nongermane amendment — agreed to in the eleventh hour of negotiations on the Social Security finance package. This significant change in the Unemployment Compensation statutes was enacted without benefit of a single hearing, without any opportunity for those who would be harmed to make their grievance known, and without a chance for Members of Congress to consider. The application of this provision has caused unduly harsh benefit restrictions detrimental to many members of the educational community.

Who Is Affected

There are a number of central issues at stake here. First, is the fact that, in many instances, these prohibitions eliminate unemployment assistance to many school employees, even though they are truly unemployed. At the same time, many school districts use the language of this law — particularly the broad and ambiguous terminology "reasonable assurance" — as a way to

avoid paying unemployment compensation. And, finally, many individuals are ineligible for unemployment — not on the basis of the kind of work they do — but as a function of who signs their checks, a local school agency or a municipal, county, or state government.

The mandatory exclusion of education support employees enacted in 1983 discriminates against a class of workers who play an essential part in the public education enterprise. Many education support employees are responsible for maintaining the health and safety conditions of our public schools, and all — from crossing guards to bus drivers to cafeteria workers — share a responsibility for the care and nurture of America's public school children. And yet, with few exceptions, education support employees are among the lowest paid workers in our society.

Moreover, when public schools meet financial difficulties because of federal, state, or local budget cuts brought about by policy changes or economic downturns, education support employees are the first to suffer. Some school districts seek to economize by avoiding unemployment compensation payments by taking pains to give "reasonable reassurance" of rehiring school employees in the spring with no intention of rehiring them in the fall. It is an economy, but at the expense of justice.

It is not support employees alone who are affected by the abuses of the "reasonable assurance" provision. In Oregon, for example, school districts laid off thousands of teachers for economic reasons and then placed them on substitute lists so that they could not qualify for unemployment compensation. Even though many of these teachers never worked a single day as a substitute, a regional office of Unemployment Compensation sytem ruled that they were ineligible.

NEA affiliates at the state and local level are making every effort to address the issues of compensation adequate to ensure qualified, experienced employees will be retained year after year, and they work to achieve contractual protections that to prevent capricious actions by school boards. But many states would prefer to address the needs of their citizens through statewide policy, and the option of covering education employees should not be closed to them.

The Unemployment Compensation System system was developed cooperatively with states, giving states broad flexibility regarding benefits, exclusions, and timelines. The original federal mandate was created to help people affected by fluctuations in the economy. And thus a federal prohibition which eliminates the states' option of covering education employees is out of synch with the history and purpose of the system.

There are countless professions where the nature of the industry, the climate, variable demand, and other factors determine that there are normal periods of the year when individuals in these professions are periodically unemployed. In no case, with the exception of professional atheletes, is there a blanket provision declaring them ineligible for unemployment assistance. The operative question for these people — as it should be for school employees — is whether or not they are unemployed. Eligiblity to receive benefits is determined on a case by case basis according to state policies designed to balance personal need and state interest, not whether or not they may be employed in the future.

The terms of employment for education employees varies widely among states and among job classifications. An education employee, such as a principal, may in some states be compensated on an annual basis and in other states be paid solely for, as an example, 190 days on the job. At the same time, within a school district certain workers may be treated differently because of the nature of their work. Many education support employees are truly seasonal employees, paid only for the work they do on an hourly basis. If these employees don't have continuing contracts, as many certificated school employees do, a non-

binding verbal agreement that they may be rehired in the fall is clearly not sufficient reason to be denied unemployment assistance.

Conclusion

There is no compelling need for a federal regulation exempting school employees. Because states have a financial obligation at stake, it is unreasonable to assume that states would abuse the program. And there is, under current law, sufficient protections against abuse by individuals. Qualifying requirements, waiting periods, and eligibilty requirements — including actively seeking work and being available for suitable work — would prevent abuses of the system. Not all covered employees would be eligible, because many education employees, both certificated and support, hold non-school employment in the summer months.

Our recommendations are in accord with a 1981 report of the National Commission on Unemployment Compensation:

> Federal law (should) be amended to remove all requirements for denial of benefits to employees of educational institutions and to limit the "equal treatment" requirement...to permit states to handle between term issues as they wish to do under state law.

What we seek is unemployment protection for those who need it, no more nor less than what almost all other workers now enjoy. At best, unemployment coverage as under the 1976 Supplemental Unemployment Assistance program should be restored for all school employees, but at the very least, states should have the option to provide unemployment assistance to education support employees as they did prior to enactment of the 1983 prohibition. We urge you to take immediate steps to address this inequity.

Thank you.

Mr. PEASE. Thank you, Ms. Dix.

Mr. Levin, do you have any questions?

Mr. LEVIN. No. We have a vote.

Might I ask that my testimony be entered into the record, Mr. Chairman?

Mr. PEASE. Yes, I'd be delighted to do so.

STATEMENT OF HON. SANDER M. LEVIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. LEVIN. Let me just say quickly we're going to be gone for awhile, and I'm not sure how we'll handle it. But the basis behind H.R. 3213 is that because of changed circumstances, we can no longer keep separate programs for income support and training and retraining. The self-employment feature is just a tiny minuscule part of the proposal, and I hope it doesn't become the focal point of discussion. We introduced this bill so that we would stimulate discussion. We are talking about using Federal trust fund moneys for demonstration projects, not the State trust fund moneys. And it's my hunch that what's true for welfare reform may well be true for unemployment comp. Tomorrow we take up a welfare reform bill which focuses substantially on issues of linkage between welfare and work. My guess is that if we can resolve that problem, it's going to enable us to improve the benefit structure. So, instead of these two areas being competitive, I personally think they're going to be supportive. At first blush, they seem to be after the same moneys, but they're really not.

Secondly, I think that attending to one is going to help us to tend to the other. And I think we must reexamine some of our thinking about it. There's a natural resistance. I think in the long run there may be support from both the labor and business community. But, at least, we are starting the debate.

I'm sorry the bell has rung. We can't debate it much longer.

[The statement of Mr. Levin follows:]

STATEMENT OF CONGRESSMAN SANDER LEVIN

Thank you for the opportunity of testifying before your Subcommittee and for including the legislation introduced by Mr. Pease and myself, H.R. 3213, on your agenda. I am looking forward to reviewing today's comments on the gamut of issues facing the unemployment compensation system.

Mr. Chairman, I think it is particularly important as we struggle with our trade deficit and the resulting worker dislocation as well as the troubled economic picture that we undertake a serious review of our unemployment programs. H.R. 3, the House passed Trade Bill, contains a number of important improvements to our national training system and our ability to respond to disclocation and long term unemployment. However, as this Subcommittee well knows, this legislation does not address the single largest program designed to assist the jobless—our Unemployment Insurance System.

In 1987, this program will expend over $16 billion in benefit payments and $2.5 billion in administrative costs. This massive expenditure dwarfs all federal training and worker adjustment programs and yet the system remains essentially unchanged since its creation 50 years ago.

Today's rapidly changing work place cries out for a modern adjustment system. A benefit payment system, funded through payroll taxes was a useful tool for protecting workers and their families, and for shoring up demand through the trough of the business cycle. A paycheck substitute was all that was needed when workers could expect to return to the same or similar occupation when the economy again picked up steam.

In sharp contrast, more and more workers fall into that category called displaced or dislocated. The jobs at which they have worked so hard for five, ten or thirty years have simply ceased to exist. As breadwinners and as proud Americans they are looking for more than transitional income. They are looking for a way back into the labor force and productive work. Today the unemployment system, through which 70% of these workers pass, gives them six months of benefits and then a cold shoulder.

We must rethink the role of unemployment insurance as nearly all of the modern economies of Europe and Japan have done. Workers who walk through the door of an unemployment office after a permanent layoff must be sought out and actively assisted. They must be given access to the programs, such as training and counseling, that he needs. And they must be given help in locating that new job.

None of this is to say that the benefit payment system must be eclipsed. Indeed as my colleagues Mr. Pease and Mr. Clinger have pointed out in their legislation, H.R. 2676, the benefit system needs substantial strengthening if it is even to begin to meet its traditional role. I think a number of witnesses today have noted that only 25% of the unemployed are now receiving benefits—an all time low figure.

My plea is that we simply must go still a further step. We must build on the current unemployment insurance system with its trained cadre of dedicated staff at thousands of offices across the nation. We must connect the disparate pieces of our labor programs, we must provide adequate funding for a true adjustment system, and above all we must provide the leadership to bring industry, labor, and all levels of government to form a working partnership.

Many of the tools are there; the question is do we have the will—or will it take another cataclysmic recession to force us to move.

Our bill, H.R. 3213, sets out the parameters of a 10 state demonstration program that seeks to create the dynamic adjustment system. The legislation establishes a primary role for the U.S. Employment Service and is based on a Department of Labor research program that ran from July of 1986 to June of this year.

Specifically, each new unemployment claim would be reviewed. Those identified as potential long-term unemployed would be targeted for special treatment, which we have called "New Start." Under New Start, the unemployed worker would receive intensive testing and counseling services, which will culminate in a plan of action. The Employability plan may lead the worker to training, job search activities, or relocation.

In addition to referral to existing program, H.R. 3213, includes what I believe is a comprehensive list of "new tools." These include such ideas as re-employment bonuses, now being tested in several states by DOL, self-employment allowance to help workers start new businesses, and Economic Adjustment Allowance to help workers starting getting into a new occupation at initially lower salaries.

Thus H.R. 3213 sets up a model to create an active adjustment mechanism. I believe, however, that two other features of the bill are perhaps more fundamental than the specifics of the program. These are the state matching grants and the use of the payroll tax to fund a broader array of services.

Matching grants are critical for two reasons. First, the unemployment system is a step child of both the federal government and state government. Its employees are state civil servants whose salaries and benefits are 100% funded by the federal government. The governors and state legislatures have traditionally shown little interest in a program for which they are not asked to contribute. Instead, they have created parallel systems for job placement, counseling, and training through the JTPA program and other similar authorities. The unemployment insurance system sits isolated, despite mandates within the law for close coordination with other programs.

While states have been ignoring the UI system, the federal government has been starving it for funds. Resources have fallen since 1980. Clearly increased federal support could help to make the program more viable. But I strongly believe that just as training has traditionally been a joint federal/state responsibility, increased resources for an expanded unemployment system should be a joint federal/state commitment.

Thus matching grants, in my opinion, would have the dual result of increasing both the amount and the effectiveness of our unemployment system.

The second major proposal in H.R. 3213 is to tap the UI Trust Funds for non-traditional services. I am well aware of the strong resistance such efforts have met in the past from many in both business and labor. But I believe those still opposing this path are short sighted for several reasons. First, almost all of the services that are outlined in our bill are now authorized by current law. The distinction I think is

one of degree and not kind, although I would submit that if "New Start" were implemented widely across the nation, most of us wouldn't recognize the old offices.

Granted, the "new tools" are clearly non-traditional. I believe, however, that this chain of precedent must not become a weight by which useful reforms are automatically drowned. Which brings me to my second point. Labor worries that additional calls on the trust funds will threaten their solvency. Business worries that new programs will demand unmanageable payroll tax increases.

I think both fears are legitimate, but both have been used to prevent any evolution of the system. H.R. 3213 taps only the Administrative accounts which are currently well in surplus. The federal payroll tax, which would fund any expanded program, is very modest, $54 a year per worker, even with the proposed extension of the temporary component. I am not going to claim that every dollar of trust fund money will save a dollar in fewer benefits, although certain programs such as the re-employment bonus may have that effect. What I do believe is that even in the medium term, the savings to government programs in general and the increased number of trained workers for business will quickly recoup the investment.

But why should we use the payroll tax? Because we need a defined source of income to provide the stable revenue base for a long term commitment to enhancing our labor force. Just as it was appropriate to use a payroll tax to stabilize worker incomes through recessions in the past, today and in the future, a payroll tax is an appropriate mechanism to stabilize the work force through the wrenching experience of dislocation.

A rapidly changing workplace is here, whether we like it or not. Foreign competition, advancing technology, and shifting consumer tastes are not going away. We must dramatically improve our ability to adapt our work force. This is the underlying purpose of the program we have put before you today.

In conclusion, I would like to say a word about some internal house keeping challenges that this Subcommittee is going to face if it begins to move aggressively on unemployment insurance reform. Our Committee has clear jurisdiction over benefit payments. But as you well know, training is at least shared with Education and Labor and the management of the Employment Service has traditionally been left to the Appropriations Committee.

Putting together a real unemployment reform package, just as in the welfare reform we will consider tomorrow, will probably entail some jurisdictional tussles. It may not be easy to travel this path, but I believe if we do not at least try, we are short changing every worker who will someday find himself or herself in a vanished occupation, and by all predictions that will be most of us.

Mr. PEASE. Thank you, Mr. Levin.

We are running short of time. It's the Chair's intention in about 2 minutes to recess the committee for a period of 10 minutes while Mr. Levin and I go over to vote. And then we'll hear from our final panel for the afternoon.

Mr. Ellenberger.

Mr. ELLENBERGER. Yes, sir.

Mr. PEASE. I thought I heard you suggest in your testimony we ought to eliminate State triggers, is that what you said?

Mr. ELLENBERGER. Mr. Chairman, we used to have a national trigger for the extended benefit program, and even though it was higher than we would have wished, it functioned at that time to provide extended benefits to those who were experiencing long-term unemployment, particularly during periods of high national unemployment.

We now no longer have a national trigger. We have State triggers. We don't like any triggers. If we have to have triggers, we think the triggers ought to be based on something that people understand. People do not understand the insured unemployment rate.

Mr. PEASE. You can say that again.

Mr. ELLENBERGER. They do understand the total unemployment rate. If there's a problem with trusting those figures, then I think we ought to do something to make them more trustworthy.

We would like to see a system of extended benefits for long-term jobless that is not based on a trigger. If a person has—in your case, Mr. Levin, a long history of working as a skilled mechanic in a plant and is thrown out of work because that plant has moved, and wants to go into business for himself, we're not too totally opposed to the self-employment suggestion. We think that person ought to retain that eligibility while attempting to go into business. It ought not be paid in a lump sum but paid as benefits are normally paid, and simply remove the provision for mandatory work search.

But, in terms of the triggers, if that person simply remains unemployed for longer than the period of time for regular State benefits, that person, just because he or she has lost their job in a period when that State doesn't have a high IUR, we shouldn't consign them to the ash heap and forget them. Those benefits, that extended benefit program, ought to be available.

Mr. PEASE. OK. Well, would you, in 30 seconds or less, be interested in the possibility of tying in unemployment benefits on a longer run basis to the number of years that an employee has in the work force?

Mr. ELLENBERGER. We would be interested, Mr. Chairman, in discussing that with you at any time.

Mr. PEASE. Well, I'd like to thank the panel, but before I dismiss you, let me just say that I personally am very much interested in long-range unemployment. A number of people have testified that the current system ought to deal with short-range unemployment, and I can understand why you don't want to dilute the system. But there is a big cliff, as I mentioned earlier, when you go off of unemployment compensation before you're eligible for welfare, I hate to put people through the wringer, getting rid of all our assets before they can qualify.

If any of you, as union organizations, would be interested in researching that or getting Brookings to do it or whatever, I think that would be a real contribution in the long run.

With that, again I thank you. I'm going to miss my vote if I don't run.

But let me thank this panel.

We'll reconvene again in about 10 minutes.

Mr. ELLENBERGER. Thank you, Mr. Chairman.

[Short recess.]

Mr. PEASE. The subcommittee will reconvene. And our witnesses today are Allen Owen, chairman, Employee Benefits and Relations Committee of the Council of State Chambers of Commerce, accompanied by William R. Brown, president.

And Isaac Shapiro, senior research analyst, Center on Budget and Policy Priorities.

I understand that Mr. Owen has a plane to catch so we'll call on him first.

STATEMENT OF ALLEN E. OWEN, CHAIRMAN, EMPLOYEE BENEFITS AND RELATIONS COMMITTEE OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE, ACCOMPANIED BY WILLIAM R. BROWN, PRESIDENT, COUNCIL OF STATE CHAMBERS OF COMMERCE

Mr. OWEN. Thank you, Mr. Pease, and thank Mr. Shapiro also for allowing us to go ahead.

My name is Allen Owen and I appear here today as chairman of the Employee Benefits and Relations Committee of the Council of State Chambers of Commerce. I am also manager of unemployment compensation and employee benefit analyst with WestPoint Pepperell, Inc., West Point, GA.

WestPoint Pepperell manufactures and markets a wide variety of textile products for apparel, household and industrial markets. We have approximately 30,000 employees located in 39 States.

Accompanying me is William R. Brown, president of the Council of State Chambers of Commerce.

The very basic issue that we have been talking about here today from the employer viewpoint is to what extent should the employer payroll tax be expected to finance the various proposals that we've seen in H.R. 2676 and H.R. 3213? And other proposals that we've talked about to expand the unemployment insurance program, where does the employer's responsibility for financing the unemployment program stop and where does society's in general assume that responsibility?

Congress has made conflicting decisions from time to time as to where the line should be drawn between the employer and society in general. The so-called temporary two-tenths unemployment tax was imposed on employers to repay the general revenue funds borrowed for extended benefits and Federal supplemental unemployment compensation benefits that was enacted in 1976.

The FSB program should have been funded from general revenues instead of payroll tax. Congress recognized this was the case when enacting the Federal Supplemental Compensation Act in 1982, and financed it from general revenues rather than from payroll tax.

Among the proposals being considered by this subcommittee is one to make the two-tenths FUTA tax permanent and fund a dislocated worker productivity trust fund. We support training programs for dislocated workers, but we do not think that a payroll tax is a proper way to finance such a program.

Also, if the two-tenths tax is spent for this purpose, it would no longer be available to help reduce the deficit which was the cry we continued to hear as we talked with Congress concerning the extension of the two-tenths FUTA tax.

Aside from any deficit issues, we believe there are very good policy reasons why the unemployment compensation payroll tax should not be used to fund other programs other than the regular unemployment benefit programs and the 13-week extended benefit program which we agree are properly the responsibility of the employer and, therefore, are properly financed by the employer through the UI payroll tax.

Economists generally recognize that payroll taxes are regressive and penalize employers for adding jobs to their payrolls. Therefore, to extend their limit, or to extend their use beyond legitimate "social insurance" benefit purposes results in very undesirable economic consequences.

One of the concerns listed in today's hearing notice is the question of the adequacy of funding for the unemployment benefit program. We believe the funding is generally adequate today to fund the present benefit programs that we have in place. However, we do emphasize that while the funding is adequate for providing benefits, which is the basic purpose of the UI payroll tax, if too much use is made of this tax for alternate purposes, other than benefits, then the adequacy of funding for the basic and extended benefit programs may certainly be endangered.

Another area being considered by this subcommittee today is whether the present measure and procedures for triggering the extended benefits program are appropriate, and we believe they certainly are.

The insured unemployment rate is the present trigger for extended benefits. It's proper because it accurately measures unemployment among those who are covered by unemployment insurance, and will ultimately qualify for extended benefits. In contrast, the total unemployment rate involves a polling process that includes individuals who have never been employed or whose last employment was many years ago and, therefore, will not qualify for extended benefits.

H.R. 2676 would replace the present trigger and the Federal-State financing provisions as we know them today. It would allow the States with the greatest levels of unemployment to pay out the greatest number of weeks of extended benefits up to 30 weeks beyond their regular State benefits of 26 weeks. The bill also provides for increased Federal funding on a sliding scale so that as the State's unemployment rate increases, the Federal Government would pay an increased share of the cost of the extended benefit program.

We do not agree with the sponsors of H.R. 2676 that it now is the time with the present low levels of unemployment and high employment to be considering a liberalization of the extended benefit program.

Not only is the need not there, but with the Federal Government's present financial situation, it is not appropriate to increase the Federal Government's proportionate cost of this Federal/State program.

The proposal to trigger extended benefits on other than a statewide basis poses both practical and equity issues. We've heard quite a few of those already during the day today. The basic problem here is the approach is not technically feasible with the present resources. It also raises serious equity problems because neighbors with similar incomes and jobs would have very different benefits simply because they're employed in different sub-areas.

Normally, it's difficult to object to demonstration projects. However, most of the projects being proposed appear to duplicate projects already undertaken by the Department of Labor. In this

time of Federal fiscal restraints, such duplicative efforts are unnecessary and, we feel, undesirable.

Section 502 of House bill 2676 provides for a special rule for certain States on the repayment of Federal loans. This proposed special rule is needed in order to ensure that employers in some States are not required to overpay their State's UC debts.

The problem is that the existing FUTA tax does not fully relate the employe penalties to the debt that the State owes. For example, Pennsylvania is projected to have a debt of 203 million on November 10th of 1988. This debt will result in an additional penalty of three-tenths percent when the State's FUTA tax payment is made in January of 1989. The additional assessment will bring the total penalty to 1.8 percent, or $475 million. Thus, $203 million will be owed, but $475 million will be repaid for an overpayment of $272 million.

To sum up, we are very supportive of efforts to retrain and place the long-term unemployed. However, we view this primarily as an obligation of society in general. Such programs should not be funded by regressive employer payroll taxes. Such taxes are properly used only for the regular unemployment benefit programs and the 13-week extended benefit program. The line should be drawn at this point.

Thank you for the opportunity to present an employer's viewpoint on what we consider a very vital program that is in place in our country at this time.

Thank you, sir.

Mr. PEASE. Thank you, Mr. Owen.

I'm prepared to ask you questions now and then turn to Mr. Shapiro, or I'm prepared to forgo the questions if you are on a tight schedule and I don't want you to miss your plane.

Mr. BROWN. Allen has the tight schedule. I can stay for the questions, if you like, and respond from the viewpoint of our organization.

Mr. PEASE. OK. Fine.

Well, feel free to leave whenever you want then.

Essentially I just want to commend you for your detailed comments on H.R. 2676 first of all. I think that's very helpful.

And to say that in general I agree with the philosophy that you've expounded that UI ought to be limited to short-term unemployment and benefits only.

Interestingly enough, the representatives of organized labor who were here today seemed to agree on that also.

Mr. BROWN. In fact, the last time I appeared with Mr. Ellenberger, we were very much in agreement on alternate uses of UI funds. We were very much in agreement with what the union representatives had to say today as a matter of fact in that regard.

Mr. PEASE. The Chambers of Commerce will march arm in arm down life's path with the AFL–CIO. That's pretty good.

What about if a case could be made that an investment of UI trust funds for training in job placement would result in a net savings to the UI Trust Fund, would that ameliorate somewhat your concern about using the trust funds for other than straight benefits?

Mr. OWEN. Let me comment. I was involved this past year with the North Carolina Employment Security Commission in an effort to possibly do something very similar. They created a secondary trust fund in order to back up their State trust fund and are using the interest from that money to help the unemployed who may fall through or just fall short of some of these programs like JTPA and be left out in the cold.

Right now, the program is just getting started up, and there really isn't any historical data to come back and say this is a good idea. We may possibly save our regular trust fund quite a bit of money. But they're applying that concept now.

We foresaw some problem with creating this trust fund since every group wanted to get their hands on it for a certain purpose. And right now that process is taking place. Hopefully, whatever comes out of that process will come out for the good of the working people of the State of North Carolina. And ultimately I feel like it will.

So, you know, maybe we'll have something to fall back on and take a look at.

Possibly, Bill, you may want to comment.

Mr. BROWN. Certainly we would take a look at any such findings and consider our position in light of such information.

Mr. PEASE. OK. It would be a little hard to track how many weeks of unemployment payments you saved by putting somebody back to work.

I just want to reiterate that I don't disagree with your general thrust at all. The reason that we are contemplating using a tiny fraction—I'm sure you've heard that phrase before—a tiny fraction of the trust fund monies for other persons relating to getting people back to work is because I think there is a potential tie in. But, beyond that and the budget atmosphere we've had over the last 5 or 6 years with huge Federal deficits, we've been unable to contemplate using society's responsibility to press through the Federal general fund to provide some of these programs. Hopefully, we may get that straightened out in a couple of years, and we can go back to a pure approach, if you will.

Mr. BROWN. I would hope at first that you take a look at carrying out the present programs and using the Federal tax to adequately fund the State administrative programs. And I would encourage you to look at the proposals of the Equity Group and the administration on administrative reform. I don't agree with Mr. Ellenberger on that, but on the part that I do agree with Mr. Ellenberger on, we're concerned about the proverbial camel under the tent. We are afraid it might just be starting down the wrong road.

Mr. PEASE. Sure. Well, I understand that concern. And there is some historical precedent that would lead you to have that concern.

Mr. BROWN. Yes, indeed.

Mr. PEASE. Mr. Owen, again my thanks to you. We'll let you try to catch your plane, and I hope you do. We appreciate your coming.

Mr. OWEN. Thanks, it was my pleasure.

Mr. PEASE. And I think we can let you go too, Mr. Brown.

Mr. BROWN. OK. Thank you.

Mr. PEASE. Mr. Shapiro, you're our star final witness here. We're going to print your entire testimony on vellum paper. [Laughter.]

STATEMENT OF ISAAC SHAPIRO, SENIOR RESEARCH ANALYST, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. SHAPIRO. Thank you. Thank you very much for the opportunity to testify here.

In a summary of my testimony, I'll focus on two basic areas. The first is the inadequacy of the current unemployment insurance system, both during the current recovery and when the next recession occurs.

I know it might be surprising at this point of the day, but I believe there are still some points to be made in this regard.

The second point that I will focus on will be an examination of the unemployment insurance system in the context of the rest of the safety net. And this has been an issue that's been largely unexplored today, and I think it's important because the fact that the unemployed basically have nowhere else to turn to, that they generally aren't eligible for other government assistance programs, brings home the point of the need to reform unemployment insurance system.

In 1987, the percentage of Americans receiving unemployment insurance will likely set a new low for the third consecutive year. For the first 11 months of this year, the coverage rate has averaged only 31 percent. In contrast to this current level, in 1978, when the unemployment rate was 6 percent, the average unemployment benefit coverage rate was 43 percent. Despite the similar unemployment rate today, the level of coverage for this year has been well below what it was in 1978.

In fact, if the same percentage of the unemployed were receiving unemployment insurance in 1987 as in 1978, then more than 900,000 additional workers would have been receiving benefits in 1987.

Part of the contraction of the system stems from the erosion of extended benefits. As has already been pointed out many times, no State now qualifies to pay these benefits, not even Louisiana with an unemployment rate of close to 10 percent. In fact, Louisiana's extended benefits were ended in March 1987, even though its unemployment rate was 13.5 percent that month.

Yet, while the extended benefits program has become substantially weaker, the number of long-term unemployed has grown. In November, there were 936,000 workers unemployed for 27 weeks or more, 44 percent more than in 1978.

The extended benefits program has failed to help those who comprise the long-term unemployed population during the current period of economic recovery. In additiion, should the economy enter into a recession, the unemployed would receive substantially less assistance from the current program than they received from the program of the 1970s.

The inadequacy of the program becomes evident when the years 1982 and 1983 are compared to the year 1975 and 1976. which is done in tables 1 and 2 of my testimony. Even though the number of unemployed people was almost 40 percent greater in the 1982 to

1983 period, the total level of unemployment insurance benefits was essentially the same in both periods. The amount of benefits per unemployed person dropped by 30 percent.

The decline in the level of unemployment insurance benefits was even more dramatic in the extended benefits program, in large part due to the program revisions in 1981.

A comparison of 1983 to 1976 yields particularly striking results. There were almost twice as many long-term unemployed people in 1983 as in 1976. Extended benefits, however, totaled $2.9 billion less in 1983 than in 1976, or less than half as much. In other words, twice as many long-term unemployed people shared an extended benefits pie that was only half as large.

The inclusion of the Federal Supplemental Benefits Program does not change the overall picture. On the contrary, the temporary supplemental unemployment insurance program also provided fewer total benefits in the 1982–85 period than the temporary program then operated in the mid-1970's. Supplemental benefits totaled $9.1 billion from 1975 to 1976, but only $6.5 billion from 1982 to 1983. These figures are adjusted to 1987 dollars.

So the inadequacy of the extended benefits program of today cannot be dismissed by the argument put forth by some of the previous witnesses that the Federal Government will enact whatever additional benefits are necessary during the next recession.

Among the States, the adequacy of the unemployment insurance system varies substantially. Table 3 contains the breakout of all the States for September of 1987. It shows that in September in 10 States fewer than one of every five of the unemployed received benefits. In only two States did more than half of the unemployed receive benefits.

I will now move on to my second area of discussion, and that is looking at alternative supports and looking at their adequacy for the unemployed.

Many of the unemployed with severe income problems, but without unemployment insurance, do not receive adequate cash assistance from other Government programs. Moreover, like unemployment insurance, many of these other Government programs also provide less assistance today than they did in the 1970s.

Some 27 States have an AFDC–UP program. However, in the typical State with such a program, benefits for a family of four with no other income have declined by 29 percent since 1970. In the 23 States without an AFDC–UP program, unemployed people who are without unemployment insurance and who live in two-parent families receive no Federal cash assistance at all.

Unemployed people who are part of a childless couple and singles are not eligible for any other Federal cash assistance program except unemployment insurance.

In addition, jobless workers without unemployment insurance cannot expect much aid from State and local cash assistance programs. General cash assistance programs have been established in many States and counties, but even where they do exist, the programs usually offer very limited assistance. In many States, assistance is limited to the disabled or, if not, the levels of assistance are quite low. Only half the States have statewide standards for these programs; even in these States, assistance tends to be limited.

In addition, 11 States have no general assistance programs at all—none at the county level, none at the State level. Nine of these States also have no AFDC–UP programs. In these States, the long-term unemployed cannot expect any government cash assistance.

It also bears noting, as has been noted by, among others, Senator Kennedy, that the unemployed tend to lack health insurance coverage as well. And even though they are generally eligible for food stamp assistance, this assistance is low. For example, for a two-parent family of four without any income, the maximum monthly food stamp benefit is now $290, or 79 cents per person per meal. This benefit amount, moreover, is reduced if the family has earnings or other income, such as unemployment insurance.

Unemployed people are not only receiving substantially less in income security, they are also receiving less assistance in finding a job. Federal employment and training programs received sharp cuts in funding during the 1980s, which is detailed in table 4.

Outlays for these programs decreased by more than half from 1981 to 1987, after you adjust for inflation. Outlays for the Federal/State Employment Service dropped by 20 percent. That's one of the programs that the proposed legislation is targeted to strengthen. And despite the extensive discussion about the need to improve the employment prospects of welfare recipients, the Work Incentive Program, designed to help AFDC recipients move into jobs, found its funding slashed by 60 percent.

The result of these trends, the decline in the unemployment insurance system, the rise of the long-term unemployed, and the inadequacy of the rest of the government assistance programs, has been an increase in poverty among the long-term unemployed.

Wayne Vroman from the Urban Institute pointed out in his analysis that, first, the poverty rate is much higher among the long-term unemployed than the other unemployed; and, second, the decline in the unemployment insurance system, and the erosion of other government assistance benefits has meant that the poverty reduction effect, the ultimate reduction in poverty occurring from these programs, has declined dramatically in the 1980s

There is a clear need to strengthen the unemployment insurance system. H.R. 2676 contains a number of positive steps to improve the extended benefits programs and to improve the links between the unemployment insurance system and job training and placement.

Thank you.

[The statement of Mr. Shapiro follows:]

TESTIMONY OF ISAAC SHAPIRO

CENTER ON BUDGET AND POLICY PRIORITIES

before the

SUBCOMMITTEE ON
PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION

HOUSE COMMITTEE ON WAYS AND MEANS

December 14, 1987

Thank you for the opportunity to testify here today. I am Isaac Shapiro, senior research analyst at the Center on Budget and Policy Priorities. The Center is an independent, nonprofit research and analysis organization that focuses on public policy issues affecting low-income Americans.

My remarks are based on a series of reports that the Center has issued over the past few years on developments in the unemployment insurance system. These reports have detailed the alarming drop in unemployment insurance coverage in the 1980s, which in part is the result of actions taken by the federal government. The low coverage of jobless workers by unemployment insurance is especially disturbing given the increase over the past decade in the number of people out of work for long periods of time (the long-term unemployed are the group of unemployed people with the highest poverty rate), and given that many of the unemployed can expect little protection from other parts of the safety net. Shoring up the extended unemployment insurance benefits program, as well as improving job training and placement for the unemployed, would be welcome steps to restoring assistance for those without work.

Record Low Coverage

In 1987, the percentage of jobless Americans receiving unemployment insurance will likely set a new low for the third consecutive year. In 1985, 32.9 percent of the unemployed received benefits in an average month, setting a new record at that time. Then in 1986, the coverage rate slipped to 32.7 percent, another new low. For the first 11 months of 1987, the coverage rate has averaged only 31.0 percent. Fewer than one of every three unemployed Americans will receive unemployment insurance.

Overall, the number of unemployed people has averaged 7.5 million for the first 11 months of 1987. During this period an average of 5.2 million of these jobless workers did not receive unemployment insurance benefits.

In contrast to the current level of unemployment insurance coverage, the average rate was 75.5 percent in 1975 and 50.4 percent in 1980, although these were recession years when coverage rates generally are higher. In 1978, when the unemployment rate was six percent, the average unemployment benefit coverage rate was 43 percent. Despite the similar unemployment rate today, the level of coverage for this year has been well below what it was in 1978.

If the same percentage of the unemployed were receiving unemployment insurance in 1987 as in 1978, then *more than 900,000* additional workers would have been receiving benefits in an average month in 1987.

This year has already witnessed an all-time recorded *monthly* low for unemployment insurance coverage.[1] This dubious record was set in October when only 25.4 percent of the unemployed, or one of every four jobless people, received unemployment insurance benefits. The previous recorded monthly low of 25.8 percent occurred in October 1985.

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1. The monthly data cover the 50 states and the District of Columbia, while excluding Puerto Rico and the Virgin Islands.

The Failure of Extended Benefits

Part of the contraction of the unemployment insurance system stems from the erosion of extended benefits. The federal-state extended benefits program is supposed to provide an additional 13 weeks of benefits to those unemployed for 27 weeks or more living in states with troubled economies, but legislation passed by Congress in 1981 has made it much more difficult for states to qualify for the program. No state now qualifies to pay extended benefits, not even Louisiana with an unemployment rate of 9.9 percent in September or West Virginia with an unemployment rate of 9.1 percent. Louisiana's extended benefits were ended in March 1987, even though its unemployment rate was 13.5 percent that month.

Yet while the extended benefits program has become substantially weaker, the number of long-term unemployed has grown. In November, there were 936,000 workers unemployed for 27 weeks or more, 44 percent more than in 1978.

The extended benefits program has failed to help those who comprise the long-term unemployed population during the current period of economic recovery. In addition, should the economy enter into a recession, the unemployed would receive substantially less assistance from the current extended benefits program than they received from the program of the 1970s.

The inadequacy of the current extended benefits program becomes evident when a comparison is made between total unemployment insurance benefit levels during years of high unemployment: 1982 and 1983 versus 1975 and 1976 (see Table 1 and Table 2; all cost figures in Table 2 have been adjusted for inflation and converted to their value in 1987). Even though the number of unemployed people was almost 40 percent greater in the 1982-83 period, the total level of unemployment insurance benefits was essentially the same in both periods. The amount of benefits per unemployed person dropped by 30 percent.

The decline in the level of unemployment insurance benefits was even more dramatic in the extended benefits program for the long-term unemployed, in large part due to program revisions in 1981. In 1982, there were nearly one and one-half times as many long-term unemployed people as in 1975. Yet extended benefits were $500 million (or 20 percent) less in 1982 than in 1975. There were significantly more long-term unemployed people in 1982, but they were receiving significantly less in benefits.

A comparison of 1983 to 1976 yields even more striking results. There were almost twice as many long-term unemployed people in 1983 as in 1976. Extended benefits, however, totaled $2.9 billion less in 1983 than in 1976, or less than half as much. In other words, twice as many long-term unemployed people shared an extended benefits pie that was only half as large.

The inclusion of the federal supplemental benefits program does not change the overall picture. On the contrary, the temporary supplemental unemployment insurance program established in 1982 also provided fewer total benefits than the temporary program that operated in the mid-1970s. Supplemental benefits totaled $9.1 billion from 1975 to 1976, but only $6.5 billion from 1982 to 1983.

The inadequacy of the extended benefits program of the 1980s cannot be dismissed by the argument that the federal government will enact whatever additional benefits are necessary during the next recession. The comparison I have just presented indicates that, in the absence of a revision to the extended benefits program, the long-term unemployed will certainly receive less aid from the extended benefits program during the next recession than they did during the 1970s, and they will likely receive less assistance from whatever supplemental benefits program is adopted as well.

State Analysis

The adequacy of the regular unemployment insurance system varies among the states. States have substantial discretion in setting eligibility requirements and benefit levels. The following data are from September 1987, the last month for which such data are available for all the states. In that month, only 27.2 percent of the unemployed nationwide received unemployment insurance benefits (see Table 3).

TABLE 1

UNEMPLOYMENT

(in millions)

	Total Unemployed	Long-Term Unemployed
1975	7.9	1.2
1976	7.4	1.3
1982	10.7	1.8
1983	10.7	2.6

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TABLE 2

UNEMPLOYMENT INSURANCE BENEFITS

(in constant 1987 dollars)

	Total Benefits Per Unemployed	Extended and Supplemental Benefits Per Long-Term Unemployed	Total UI Benefits (billions)	Regular Benefits (billions)	Extended Benefits (billions)	Supplemental Benefits (billions)
1975	$3,266	$3,741	$25.8	$21.3	$2.6	$1.9
1976	4,487	9,496	33.2	20.4	5.6	7.2
1982	2,336	1,239	25.0	22.8	2.1	0.1
1983	3,065	3,556	32.8	23.7	2.7	6.4

Source for Tables 1 and 2: U.S. Department of Labor, House Ways and Means Committee, and the Congressional Budget Office. The unemployment figures are for the calendar year while the benefit amounts are for the fiscal year.

Table 3: UNEMPLOYMENT INSURANCE COVERAGE, SEPTEMBER 1987, FOR ALL STATES

	Unemployment Rate	Number of Unemployed	% Receiving Benefits	Unemployed Not Receiving Benefits
ALABAMA	7.0%	133,900	22.7%	103,511
ALASKA	8.6%	22,000	44.3%	12,261
ARIZONA	5.7%	92,600	23.1%	71,192
ARKANSAS	7.1%	79,300	24.4%	59,962
CALIFORNIA	5.5%	764,800	39.0%	466,376
COLORADO	6.0%	100,100	24.3%	75,727
CONNECTICUT	2.8%	50,700	31.0%	35,006
DELAWARE	2.5%	8,100	27.0%	5,917
D.C.	6.4%	21,800	38.9%	13,328
FLORIDA	5.3%	310,500	18.7%	252,482
GEORGIA	5.0%	153,400	24.0%	116,622
HAWAII	3.8%	18,600	37.1%	11,700
IDAHO	5.5%	25,900	35.4%	16,739
ILLINOIS	6.1%	355,300	27.8%	256,388
INDIANA	5.6%	154,600	16.9%	128,467
IOWA	4.8%	67,800	23.7%	51,735
KANSAS	4.0%	49,300	37.9%	30,603
KENTUCKY	6.8%	114,200	19.3%	92,118
LOUISIANA	9.9%	197,600	24.1%	149,932
MAINE	2.9%	17,800	37.4%	11,140
MARYLAND	3.9%	93,200	27.1%	67,955
MASSACHUSETTS	2.8%	84,200	52.9%	39,659
MICHIGAN	7.3%	333,500	29.7%	234,585
MINNESOTA	4.6%	104,100	22.6%	80,528
MISSISSIPPI	8.9%	105,300	18.3%	86,073
MISSOURI	5.4%	140,700	25.9%	104,200
MONTANA	5.5%	21,700	25.3%	16,201
NEBRASKA	3.9%	31,100	21.5%	24,400
NEVADA	5.3%	30,000	28.5%	21,447
NEW HAMPSHIRE	2.1%	12,400	14.7%	10,578
NEW JERSEY	3.9%	152,500	39.0%	92,990
NEW MEXICO	8.3%	56,000	18.2%	45,824
NEW YORK	4.4%	368,700	40.1%	220,888
NORTH CAROLINA	3.5%	116,400	25.6%	86,612
NORTH DAKOTA	3.4%	11,300	25.5%	8,416
OHIO	5.5%	286,600	28.5%	205,050
OKLAHOMA	5.9%	91,400	21.5%	71,771
OREGON	5.4%	73,600	39.5%	44,558
PENNSYLVANIA	5.2%	296,700	34.8%	193,516
RHODE ISLAND	3.1%	16,000	55.9%	7,060
SOUTH CAROLINA	4.5%	74,100	25.8%	54,968
SOUTH DAKOTA	3.9%	13,900	13.2%	12,066
TENNESSEE	6.2%	147,200	21.7%	115,320
TEXAS	8.5%	717,300	17.7%	590,165
UTAH	5.6%	42,200	22.5%	32,704
VERMONT	2.9%	8,500	29.3%	6,009
VIRGINIA	4.0%	121,400	12.7%	105,986
WASHINGTON	6.2%	139,800	38.5%	85,951
WEST VIRGINIA	9.1%	67,400	22.0%	52,589
WISCONSIN	4.4%	109,200	28.0%	78,660
WYOMING	6.2%	15,400	19.2%	12,444

Source: Compiled from U.S. Department of Labor data

In September, in *10* states, *fewer than one of every five* of the unemployed received benefits. In only two states did more than half of the unemployed receive benefits. Virginia had the lowest coverage rate in the nation, with just 12.7 percent of its unemployed receiving benefits.

Among the most populous states:

- In Florida, only 18.7 percent of the unemployed received benefits in September. Some 252,000 jobless workers there received no benefits.

- In Texas, where the state's September unemployment rate of 8.5 percent was substantially above the national rate, only 17.7 percent of all jobless workers were covered. Some 590,000 jobless workers received no benefits.

Among other states with high unemployment rates:

- Louisiana's unemployment rate of 9.9 percent was the highest of any state in the nation, but more than three of every four of its unemployed were without benefits.

- West Virginia had an unemployment rate of 9.1 percent, but only 22 percent of its unemployed received unemployment insurance.

Low coverage is not restricted to the South or to states with exceptionally high unemployment rates. In the Midwestern states of Illinois and Ohio, for example, only a little more than one in four of the unemployed received benefits in September. In Illinois, 27.8 percent of the unemployed received benefits, while 256,000 did not. In Ohio, 25.6 percent received benefits; 224,000 did not. Even in states such as New York and California with relatively high coverage (40.1 percent and 39.0 percent respectively), substantially fewer than half of the unemployed received benefits.

Alternative Supports Are Also Inadequate

Many of the unemployed with severe income problems but without unemployment insurance do not receive adequate cash assistance from other government programs. Moreover, like unemployment insurance, many of these other government programs also provide less assistance today than they did in the 1970s.

Some 27 states and the District of Columbia have an AFDC-UP program which provides cash assistance to two-parent families with an unemployed primary earner. However, in the typical state with an AFDC-UP program, benefits for a family of four with no other income have declined by 28.9 percent since 1970. In the 23 states without an AFDC-UP program, unemployed people who are without unemployment insurance and who live in two-parent families receive no federal cash assistance at all.

Unemployed people who are part of a childless couple and singles are not eligible for any other federal cash assistance program except unemployment insurance.

In addition, jobless workers without unemployment insurance cannot expect much aid from *state* and *local* cash assistance programs. General cash assistance programs have been established in many states and counties, but even where they exist the programs usually offer very limited assistance. In many states, assistance is limited to the disabled or, if not, the levels of assistance are quite low. Only half the states have statewide standards for these programs; even in these states, assistance tends to be limited.

In addition, 11 states have no general assistance programs at all. Nine of these states, including Louisiana, North Dakota and Texas, also have no AFDC-UP programs. In these states, the long-term unemployed cannot expect *any* government cash assistance.

People who receive AFDC are automatically eligible for Medicaid. However, in families with an unemployed member but without AFDC, some or all family members may receive Medicaid *only* if a state selects certain Medicaid options.

Singles and childless couples who are neither elderly or disabled are almost never eligible for Medicaid. The unemployed who lack Medicaid or other health insurance are forced to rely on scanty state and local medical assistance programs for the indigent, if they receive any medical assistance at all.

Food stamps are available to the unemployed if their assets and incomes are low enough. These benefits, however, are also quite limited. For example, for a two-parent family of four without any income, the maximum monthly food stamp benefit is now $290 -- or 79 cents per person per meal. This benefit amount is reduced if the family has earnings or other income (including income from government cash assistance programs such as unemployment insurance).

Cuts in Employment and Training Programs

Unemployed people are not only receiving substantially less in income security, they are also receiving less assistance in finding a job. Federal employment and training programs received sharp cuts in funding during the 1980s (see Table 4).

Outlays for federal employment and training programs decreased by more than half, or 56.9 percent, from fiscal year 1981 to fiscal year 1987, after adjusting for inflation. Outlays for the federal/state Employment Service dropped by 20 percent. Despite much discussion about the need to improve the employment prospects of welfare recipients, the Work Incentive program, designed to help AFDC recipients move into jobs, found its funding slashed by 60 percent. Even the much-heralded Job Corps program had its funding reduced.

Unemployment and Poverty

A number of studies have shown how much of a toll the decline in unemployment insurance benefits has exacted on low-income households. Workers who experience long-term unemployment are more likely to experience poverty than jobless workers as a whole. Urban Institute Analyst Wayne Vroman found that in 1983 the poverty rate before receipt of any government benefits was 17.1 percent for people unemployed for less than 13 weeks. For people who were out of work 51 to 52 weeks, the poverty rate before receipt of benefits soared to 59.9 percent -- three and one-half times greater than the rate of the first group.

In addition, Vroman examined the extent to which government benefits reduce poverty rates. He found that in 1976, unemployment compensation and other government benefits reduced poverty rates for those people who both were unemployed for 40 to 52 weeks and received unemployment insurance benefits by 35 to 38 percentage points. In 1983, however, poverty rates for the same group of long-term unemployed were reduced only 22 to 25 percentage points by unemployment insurance and other benefits.

According to Vroman, "It is clear that the long-term unemployed experience very high poverty rates and that UI benefits have a substantial poverty-reducing impact." He concluded, "In the absence of some alternative new program, and given the particularly large amount of long-term unemployment experienced in the 1980s, it seems to be clear that UI benefit cutbacks have contributed to economic hardship and to occurrences of poverty in the 1980s."

Sheldon Danziger and Peter Gottschalk of the Institute for Research on Poverty at the University of Wisconsin-Madison examined the circumstances of workers who were employed at low-wage jobs but then lost their jobs and joined the ranks of the unemployed. They found that most unemployed household heads who had previously held low-wage jobs did not receive unemployment insurance benefits, and that the proportion that did receive benefits had decreased substantially in recent years. Moreover, these jobless workers and their families received little in the way of cash assistance from other programs. As a result, they were "at a high risk of poverty."

Reforms

There is a clear need to strengthen the unemployment insurance system. Legislation (H.R. 2676) introduced in a bipartisan effort by Representatives Pease and Clinger contains a number of positive steps to improve the extended benefits

Table 4. EMPLOYMENT AND TRAINING OUTLAYS: Fiscal Years 1981 and 1987
(Constant 1987 Dollars, in millions)

	Fiscal 1981	Fiscal 1987
Block Grants to States	0	1,848
General CETA Programs	4,260	0
Summer Youth Employment Programs	969	684
Dislocated Worker Assistance	0	180
Job Corps	680	626
Older Americans Employment	349	321
Work Incentive Program	480	193
Other Training Programs	869	227
Federal-State Employment Service	1,013	800
Public Service Employment	3,023	0
Targeted Jobs Tax Credit (tax expenditure)	384	300
Total	12,028	5,179

Source: U.S. Department of Labor, 1982 Employment and Training Report and Mid-Year Budget Review, June 1987. Office of Management and Budget, Budget Documents.

program and to improve the links between the unemployment insurance system and job training and placement.

The bill, appropriately, would adjust the duration of extended benefits depending on the state's unemployment rate. The jobless in states with higher unemployment rates would be eligible for more weeks of extended benefits. The legislation also would establish a sliding scale of matching federal-state funding for extended benefits. Such a cost-sharing proposal is sensible because states with high unemployment rates are also less likely to be able to afford government expenditures to address the problems of the jobless.

H.R. 2676 would also take the essential step of adding an alternative "total unemployment rate"[2] trigger. States would be eligible for extended benefits if their unemployment rate (the number of unemployed people as a percentage of the labor force) or their "insured unemployment rate" (the number of unemployed people receiving unemployment insurance as a percentage of the labor force) were high enough. Currently, eligibility for extended benefits is dependent only a state's *insured* unemployment rate, but this trigger level is both set too low and is not always an accurate reflection of a state's unemployment problems.

For example, once jobless workers exhaust their unemployment insurance benefits, they are no longer counted in the *insured* unemployment rate trigger. Therefore, states with substantial long-term unemployment can have a relatively low *insured* unemployment rate. If a state's unemployment rate remains unchanged, but the number of unemployed exhausting their unemployment insurance benefits increases, the state's *insured* unemployment rate actually falls. The state's economy can be in just as bad shape, but the likelihood of receiving extended benefits decreases. It is the peculiarities of the *insured* unemployment rate that has resulted in states such as Louisiana becoming ineligible for the extended benefits program earlier this year despite its very high unemployment rate.

H.R. 2676's provisions to expand training for UI recipients and to strengthen the Employment Service also are promising. Both measures could help move more unemployed people into jobs.

Financing

Strengthening the unemployment insurance program will require greater government expenditures. In the search for sources of financing, raising the federal taxable wage base is worth scrutinizing. The federal taxable wage base for unemployment insurance, which determines the minimum state taxable wage base, has been raised only three times from its initial level of $3,000 in 1935. More than half a century later the level is only $7,000. Consequently, the ratio of taxable wages to the total wages of covered employees has declined from 98 percent in 1940 to 34 percent in 1986. In comparison, the Social Security maximum tax base ($43,300 in 1987) is more than six times as high.

With a low base, employers generally pay the same amount of tax for all workers earning at or above the minimum level. This low tax base acts as an employment disincentive. Unemployment insurance taxes, as a semi-fixed cost, increase the incentive for firms to lengthen workers' hours at no additional unemployment insurance expense rather than to hire a new worker and increase unemployment insurance costs by a substantial amount. It also bears noting that even though contributions per employer vary little with a worker's wages, UI benefits do vary with earnings. A low wage employer may contribute as much as a high wage firm to the system, but the low wage worker receives substantially less in benefits payments.

Raising the taxable wage base would be a good approach to funding the needed reforms to the unemployment insurance system.

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2. The "total unemployment rate" is commonly referred to as the "unemployment rate."

Mr. PEASE. Thank you very much, Mr. Shapiro.

I enjoyed your testimony and I think it was very helpful to us.

I think it was particularly helpful for you to put unemployment compensation benefits in the context of other safety net programs.

I continue to run into people who want to limit unemployment compensation to short-term unemployment, which really means 26 weeks now. Those people seem not to have given any thought to what happens to the workers after 26 weeks and what happens to the family.

That is a concern of mine, and I'm inclined to think at this point that we probably ought to try to address it outside of the standard unemployment compensation program. But if there's no other way to do it, then I would try to accommodate it within the current system.

I have been, as you heard me say earlier this afternoon, particularly concerned about the fact that when a person goes off unemployment compensation, the next stop is welfare. There is a long way between those two stops, as inadequate as welfare is, and as much of an insult as welfare is to the worker who's put 15–20 years into a job without being laid off that whole period of time, the real insult comes when the worker finds out he's got to sell his car and his boat and his motor home and anything else he owns that has any kind of value before he can pick up the piddling amount of money that's available on welfare.

Do you have any thoughts offhand to give the Subcommittee on what might be an appropriate bridge between standard unemployment compensation and welfare?

Mr. SHAPIRO. That's exactly, I believe, what the extended benefit program is intended to accomplish and has not been accomplishing.

I think you're right. There's fundamentally different purposes between the welfare system and the unemployment insurance system. The unemployment insurance system is designed to address the problems of the unemployed who have a temporary break in their work life without reducing their standard of living dramatically.

The only way that the long-term unemployed may get assistance, is, as you mentioned, if their assets and income drop enough and, unfortunately, given the high rate of poverty among the long-term unemployed, that has been happening to a lot of ex-workers.

The welfare system is not really designed for the long-term unemployed. It's a separate system that's designed for a different group of people, so in a way it's not surprising that it's not picking up those folks.

I think that both systems need to be strengthened. Actually there are three systems we're talking about. We're talking about the unemployment insurance system for those temporarily unemployed. And we're talking about income assistance in these other programs, such as AFDC–UP. And then we're talking about employment and training. And when all three areas have been cut, as happened in the 1980's, the result is going to be greater hardship.

Mr. PEASE. Well, I guess I'm really interested in a fourth program, if you will.

I agree with you that the extended benefits are helpful to a long-term unemployed person. But given the level of unemployment

that provides an extra 10 weeks, 30 weeks under our bill, there's nothing under the current law.

But it seems to me that even if we were to win approval of our extended benefits reform in H.R. 2676, there would still be people, in my mind's eye, I view them as people, 45, 50, 55 years of age who are going to be unemployed after 26 weeks plus 20 weeks, or 26 weeks plus 30 weeks. And there will be a somewhat smaller number.

But I'm wondering if we ought not to try to fashion some program that could carry those people for two or three or four years, perhaps at a declining level of support, to let them down more gently into the welfare category.

Does that sound feasible at all to you?

Mr. SHAPIRO. The link is worth investigating, that is, the link between UI benefits and job training, and certainly the problem addressed in your legislation that would allow people to be trained while they're receiving unemployment insurance benefits is something that's eminently sensible.

Department of Labor representatives and other members of the administration often suggest, as they did earlier today, that instead of an increase in the minimum wage or unemployment insurance, we should turn to the employment and training system. That point would be a lot stronger on their behalf if they hadn't helped push for the dramatic reduction in those employment and training programs that has occurred in this decade.

I think the need to link the two systems together is especially important to investigate, and the use of unemployment insurance trust fund towards this effort may make sense because the basic employment and training system has declined so much.

Mr. PEASE. Well, I couldn't agree with you more. I probably let the Department of Labor off too easily previously because they have cut back on these programs.

The other thing that strikes me as shortsighted about the Department of Labor position is that they talk a great deal about employment and retraining for workers, but they don't have much, if any, income maintenance factor into that. And the idea of expecting the worker, 45–50 years, to go through retraining when his benefits have been exhausted and he's got no money at all I think really is a little ridiculous.

So I just made a note to myself that maybe we need to tie in a fairly long period, 2, 3, 4 years, perhaps of declining levels of benefits, with a requirement in participation in training and retraining so that the worker couldn't just take his 3 years' worth of benefits and sit it out for that period of time.

Okay. Well, again, I thank you for not only your testimony but your patience. And we will definitely put a star beside your name in the committee report.

Thank you.

Mr. SHAPIRO. Thank you very much.

Mr. PEASE. This is the end of this hearing. I'd like to thank all of our guests for sticking it out for so long. It shows real devotion to this subject.

[Whereupon, at 3:42 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATE OF CONNECTICUT
DEPARTMENT OF LABOR
200 FOLLY BROOK BOULEVARD
WETHERSFIELD, CONNECTICUT 06109

P. JOSEPH PERARO
COMMISSIONER

December 21, 1987

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

Transmitted herewith is Connecticut's response as requested in your PR #8, dated Monday, December 14, 1987.

Very truly yours,

P. JOSEPH PERARO
Labor Commissioner

Attachment
CC: Ann Sullivan

(1) Do the States have sufficient reserves in their unemployment funds?

Revenue exceeded costs by $50 million during the past year and Connecticut presently has an unemployment trust fund balance of $271 million. Under present conditions it might appear that reserves are sufficient.

However, a realistic response to the question of whether there are sufficient reserves in the unemployment fund must be approached from an historical perspective. But, first, to make the data for different years comparable fund balances, benefit costs and similar statistics must be transformed to percentages of total wages for the years being compared. In the ten years between 1976 and 1986, covered employment increased by 334,000 and it now takes almost twice as many dollars to maintain the same purchasing power as ten years ago. Total wages compensate for both these changes so that differences between statistics based on percentages of total wages are due to the business cycle and not labor force growth and inflation.

While there is no official standard, the most often cited guideline is that reserves should equal 1.5 times the highest cost incurred for a 12-month period. For Connecticut, the highest costs were the 12 months ending December 1975 when benefit costs were 3.29 percent of total wages. Multiplying this by 1.5 yields a suggested reserve level of 4.93 percent of total wages. In terms of 1987 total wages which are expected to top $32 billion, reserves should be $1.6 billion according to the 1.5 multiple standard. Actual reserves at the present time are $271 million, less than 17% of the suggested level.

While present reserves in Connecticut are not adequate, a review of other states shows that at least as of the latest data available (1986), only one state (Mississippi) had a reserve multiple greater than 1.5 and only six states had reserves which exceeded 1.0 times their high cost. A total of 38 states had a higher reserve multiple in 1986 than Connecticut.

A final consideration regarding reserves adequacy is the delayed response of the benefit financing system when it becomes evident that costs are exceeding revenue. If, for example, costs begin to increase dramatically at the beginning of 1988, there would be no increase of revenue before April 1989.

So our response to whether Connecticut has sufficient reserve unemployment funds has to be 'no', primarily because the present balance and anticipated revenue will not be adequate to meet the benefit costs that will result from a serious economic downturn. Increasing revenue will not occur again until increased costs have already been incurred. If those increased costs are substantial, debt is inevitable.

(2) Do existing programs provide adequate coverage of the work force?

Approximately 90 percent of Connecticut's 1.8 million work force is covered. Since most of those not covered are self-employed, we feel that existing programs do provide adequate coverage.

(3) Would the current Federal-State Extended Benefits Program provide the additional protection needed during a period of high unemployment?

The creation of the reserve for the Federal/State Extended Benefits Program may be inadequate, and some raising of ceilings of the Extended Unemployment Compensation Account and the Federal Unemployment Account may be warranted. However, the statutory limits would never be reached if the percentage of .0125 of taxable wages were raised to .0150 or greater of taxable wages. There would be no surplus of monies to be distributed to the states in the form of "Reed Act" credits.

(4) Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions in these programs that have been enacted in recent years?

There has been little federal legislation in recent years requiring states to enact conforming legislation which adversely affected the remedial abilities of unemployment compensation benefits payable under the regular program. There have been significant changes with respect to several federal unemployment compensation programs which are administered by the states on an agreement basis and to the Federal-State Extended Benefits Program. These changes can be perceived as lessening the effectiveness of these programs during high unemployment periods. They are discussed below.

The Federal Unemployment Compensation for Ex-Servicemembers (UCX) program provides benefits to separating members of the military. For many years, this program paid benefits in a manner consistent with regular compensation. Since 1980, the program has undergone a marked change that limits the number of individuals eligible and the duration of benefits. A separating servicemember cannot become eligible for benefits until the fifth week following discharge. Most states have a one-week waiting period, or none. Such an individual cannot be paid more than 13 weeks of benefits in a benefit year which would preclude any eligibility for extended benefits once he has received the basic entitlement. Most states provide 26 weeks of basic entitlement prior to extended benefit entitlement. A servicemember separating during a high unemployment period will be at a great disadvantage when compared to his counterpart in the civilian labor force.

The Trade Adjustment Assistance program is a component of the Trade Act of 1974 and amendments. It is a UC program available to workers whose employment has been certified as being adversely affected by foreign competition. The program, in its current form, functions primarily as an extended benefit program. In recent years, the TAA program was the focus of legislative and other initiatives that first drastically reduced its sheltering effects, but recently restored some of those effects. One facet of the administration of the program that still is impaired deals with establishing monetary entitlement. Section 233 (a) (1) of the Trade Act of 1974, limits the amount of TAA payable to 52 times the worker's weekly benefit amount of UI minus the total sum of the UI to which the worker was entitled (or would have been entitled if he had applied therefore). This has been interpreted to mean that in all cases the full dollar value of UI entitlement during the first benefit period will be deducted from the TAA entitlement.

This unique method of computing entitlement has two profound effects. First, it provides a strong disincentive to return to work for the adversely affected employee (or accept any employment) due to the fact that overall entitlement is decreased rather than enhanced by such efforts. Secondly, if such a worker (whose skills are normally not readily marketable due to their being hidebound to that industry) is separated during a high unemployment period, he is at double jeopardy with half the protection. His reason for being unemployed is recognized under law as requiring added remedial measures (TAA), while the high rate of unemployment (and limited job opportunities) triggers extended benefits to any unemployed worker, including the TAA worker. Those workers who are unemployed due to economic vagaries will find calls for their skills as the economy begins to improve. The TAA worker may not find such calls, yet his TAA entitlement has been reduced by the amount of any extended benefits he received while his reason for being out of work remains the same. His unemployment is the direct result of two separate influences and each of those influences has a UC remedy; yet, we expect his double-edged problem to be solved by the application of only one remedy and deny him access to the second.

The Extended Benefit (EB) program is a joint federal-state program and is a permanent provision of law at both levels. Since the beginning of this decade, the EB program has had numerous changes to it that can be perceived as reducing its effectiveness.

The trigger mechanisms that are used to compute when the EB program will be in effect have been altered from those that existed in the 1970's and prior. The national "on" indicator has been eliminated. The national "on" indicator triggered the program when the national Insured Unemployment Rate (IUR) met or exceeded 4.5 percent. While there are valid arguments that a state with a very healthy economy could be in an EB period solely as a result of the national IUR, there is also evidence that certain industries, groups of workers, or locales, within a healthy economy could suffer disproportionately as a result of influences reflected in the

national IUR. The state IUR percentages that can cause the program to trigger "on" have been raised a full percentage point as a result of conformity requirements since the 1970's making EB harder to trigger "on". In addition, prior to 1982, the method used to compute the IUR (counting weeks of claim filing) included counting weeks paid under an extended program. It is now limited to counting weeks paid only on the regular program. This feature makes it difficult to maintain the trigger level once it is "on" potentially denying the program to claimants exhausting regular benefits and can distort the true picture. There are also implications that the national trigger should be restored.

There have also been significant changes to the eligibility criteria of the EB program that have had the effect of reducing the number of people eligible. These include requiring a greater amount of wage credits to establish EB entitlement than was required to establish the basic UC entitlement on which the EB is based.

Another change to EB eligibility required that no individual who had been subject to a disqualification for voluntary leaving, discharge for misconduct, or work refusals while in the regular program could collect EB unless the state law provided for a purge of that disqualification by weeks of work or earnings, or a combination. If the state law provided for any other type of purge, the individual could not collect EB.

Finally, one of the law changes imposed a stringent disqualification for failing to maintain certain eligibility requirements. The EB program requires as a condition of eligibility that individuals, for each week claimed, make a systematic and sustained effort to obtain work if they do not have immediate prospects of employment and provide documentation of such efforts. While there is little reason to quarrel with requiring a search for work, although during extremely high IUR periods the wisdom is questionable, the penalty for failing to do so is severe. An individual who fails to meet the work search requirement is disqualified until he has become reemployed for four weeks and earned not less than four times his EB weekly benefit amount.

(5) Are there alternative uses of UC funds that could improve the efficiency of labor markets?

There is nothing we have seen in any of the demonstration projects by the Department of Labor that would improve efficiency. There have been no final reports presented showing the costs in trust fund dollars or what actual savings have occurred. There have been no benefit/cost analyses completed.

Our concern is that once the door is opened for alternate uses of trust fund dollars, it would bring on a flood of programs that would reduce the already low reserves. A prolonged downturn in the economy, one year or more, would put many states into a borrowing situation.

A trust fund for the sole purpose of paying benefits to individuals, who are unemployed through no fault of their own, has been the cornerstone of the Unemployment Insurance system for over fifty (50) years. To tamper with the trust funds could affect the confidence of the labor force of this country in the entire system, and the knowledge that monies are available when they are needed the most.

Written Statement of
Robert E. Friedman, President
Corporation for Enterprise Development

I am Robert Friedman, President of the Corporation for Enterprise Development (CfED), a non-profit organization which has worked for nine years with state and local policymakers, private corporations, unions and community organizations to design and implement effective economic development strategies, particularly in chronically poor communities and communities hard hit by plant closings.

I am very pleased to be able to submit this testimony today in support of the potential of self-employment allowances for improving economic security and labor market efficiency.

I will focus my remarks on the self-employment provisions of H.R. 3545, the Budget Reconciliation Act of 1987, Section 9242, and Title III of H.R. 2676, "the Extended Unemployment Insurance Reform Act of 1987." But I want to acknowledge at the outset that including efforts to promote self-employment as a response to dislocation constitute only part of an adequate response to the challenge of economic restructuring and dislocation: different dislocated workers and communities will escape unemployment through different routes; it is our job to open as many of those routes as possible.

I have divided my testimony into five sections:

1. Why Open a Self-Employment Option?
2. Entrepreneurship, Self-Employment and Economic Renewal
3. Barriers to Self-Employment
4. Precedents and Program Models
5. Pursuing the Experimentation

1. Why Open a Self-Employment Option?

In many of the communities of this country hardest hit by international competition and economic restructuring -- from timber communities of the Northwest to the textile-mill towns of the Southeast, from the mining communities of the Southwest to the steel communities of New England, from the automobile communities of the Midwest to the farming communities of the Plains -- the underlying problem is a loss of jobs and enterprise. When the best of traditional remedies run their course -- when the advance notice period has expired, when severance pay and unemployment compensation have been exhausted, when counselling and placement assistance has ended, when retraining has been completed, when what few people who are willing to move have moved -- many dislocated workers will still face the reality that there are not sufficient job opportunities to absorb them. For these individuals -- and for these communities -- part of the challenge of economic change is to sow the seeds of a new economy, to create enterprises which can grow to replace the jobs and enterprises that have been lost. And one of the sources of this new growth will be the unemployed themselves.

2. Entrepreneurship, Self-Employment and Economic Renewal

Indeed, what is remarkable about the last decade of rapid restructuring of the American economy is not only the dramatic loss of plants and jobs, but the rise of entrepreneurship in the face of dislocation. The increasing role of entrepreneurship in this economy -- the 65 percent rise in business incorporations and the 45 percent rise in self-employment from 1970 to 1984[1] -- is a response both to new opportunities, and dislocation. The best evidence that we have is that 1/2 of new jobs generated over the last decade and a half have come from independent firms under

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[1] U.S. Small Business Administration The State of Small Business (Washington, D.C.: U.S. Government Printing Office, 1984, 1985, 1986).

5 years of age.[2] Moreover, triggers for entrepreneurship are more often negative than positive -- loss of a job, loss of a spouse, being caught in a dead-end job.[3] Many entrepreneurs are entrepreneurs of necessity.

What distinguishes "dislocated communities" from others is not the fact that firms are dying or plants are closing, but rather the speed and scale of the losses, relative to the existing enterprise and job base. But even in these communities there is evidence of renewal. In Europe:

- Since its formation in 1975, BSC Industry, a wholly-owned subsidiary of British Steel Corporation devoted to creating jobs in steel closure areas, has helped more than 2,000 firms start or grow, creating 30,000 new jobs with another 20,000 projected. Although the number of jobs replaced makes up for only a portion of those lost, and the jobs created will many times not go to the former British Steel Corporation employees, still BSI has set up a visible process for renewal in communities that saw their major employer shut down. In cities like Corby, this process has already succeeded in replacing half of the jobs lost and quintupling the number of business in existence.[4]

- In Landeskrona, Sweden, 65 percent of the jobs lost in the shipbuilding industry decline have been replaced by start-ups of new firms.[5]

- Though much of the loss of employment in firms has occurred in manufacturing, in north-central Italy there is more manufacturing employment today than there was 15 years ago, but it takes a very new form. There, half a million firms with average employment of five employees, each, managed in many cases by former factory hands, employ the latest computer technology and join together in flexible networks to provide specialized products. 325,000 firms in Emilia Romagna Region alone, some 90,000 of which are in maufacturing, have resulted in incomes of 75% the Italian norm. [6]

There is U.S. evidence of the possibilities as well:

- Entrepreneurial renewal has had its clearest impact in the six northeastern states of New England, where the unemployment rate has declined from 12 percent in 1974 to 4.5

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2 Birch, Job Generation Process; Candee Harris, "Misconceptions about Small Business Hiring" (Paper delivered at the Consolidated Gas Supply Corporation's Economic Development Seminar, June 10, 1983, Canandaigua, NY); Michael B. Teitz, Small Business and Employment Growth in California (Berkeley: University of California, Institute of Urban and Regional Development, 1981). Note: Marc Bendick and Mary Lou Egan in testimony submitted at these hearings deceptively cite contrary findings from earlier work here superceded.

3 Albert Shapero, "The Social Dimensions of Entrepreneurship," in Encyclopedia of Entrepreneurship by Donald L. Sexton, et al. (Englewood Cliffs, NJ: Prentice-Hall, 1982), p.82.

4 William Schweke and Rodney Stares, Sowing the Seeds of Economic Renewal (Washington, DC: Corporation for Enterprise Development, 1986).

5 Ibid.

6 Richard Hatch, "Reviving Local Manufacturing Italian Style," City Limits (April, 1986), pp.16-19. See "Flexible Manufacturing Networks," The Entrepreneurial Economy" (Washington, DC: Corporation for Enterprise Development, July/August 1987, Vol. V, Issue 5.

percent in 1985. New England lost 252,000 manufacturing jobs between 1968 and 1975, but replaced most of them -- 225,00 -- in the ensuing five years.[7]

- Researcher Candee Harris, studying job loss and job replacement, found that during the last recession:
  - An employee was less likely to lose a job if he or she was employed in a firm employing under 100 employees than one employing over 100.
  - While larger firms lost net employment, small firms continued to gain; that is, small firms were countercyclical in their job creation performance.
  - The small business contribution to job generation and job stability was greatest precisely in those industrial sectors and those regions that underwent the greatest decline.[8]

Indeed, without any support, 7.7 percent of workers displaced in 1979 who had become reemployed by 1984 created jobs for themselves. In industries like finance and services, construction, and utilities the rate exceeded 11 percent.[9]

Self-employment is most often seen as the lowest cut on the size spectrum. But it can also be seen as the first step in the evolution of enterprise, the foundation of an entrepreneurial culture -- important not only for the jobs and income that directly result, but also for the effect on neighbors and friends and children who will be encouraged to start businesses as a result.

We know that a primary cause for entrepreneurship is having a parent or relative who started a business; that phenomenon ought to work prospectively as well.

There is, of course, a down-side to self-employment and entrepreneurship. The two most frequently mentioned are failure rates and quality of jobs.

Indeed, the failure rate of young and small businesses is high, though not nearly as high as commonly assumed. The best data we have on small business failure rates comes from Dun and Bradstreet and suggest that less than 1/2 percent of all businesses die each year with loss to creditors. Of the 50,000 or 60,000 businesses that failed each of the last several years, 80 percent survived their first two years. The big failure rate years are years three, four, and five, when roughly 15 percent of those that fail, fail, so that of those that fail, 60 percent fail within five years. Thereafter the failure rate drops rapidly, but by the end of 10 years, 81 percent of all businesses have failed.

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7 James M. Howell and Linda D. Frankel, "Economic Revitalization and Job Creation in America's Oldest Industrialized Region" (Unpublished remarks at the American Enterprise Institute, Washington, DC, 2 December 1985), p.1. See also Gary Gappert, ed., Winter Cities (Beverly Hills, CA: Sage, 1986).

8 Candee S. Harris, "The Magnitude of Job Loss from Plant Closings and the Generation of Replacement Jobs: Some Recent Evidence," The Annals of the American Academy of Political and Social Science, 475:15-27 (September 1984).

9 Alternative Uses of Unemployment Compensation (Washington, DC: U.S. Department of Labor, March 17, 1986), p.57.

A much larger number of businesses close without loss to creditors; they may entail some personal loss or they may simply reflect the desire to do something else, or even to start a higher-value-added business. Our data on such closures are even poorer, but the best estimates are that 7 to 8 percent of all businesses close each year. We suspect that their age of distribution is similar to their failures distribution, that is, that most will survive their first two years and that the big failure-rate years will be three, four, and five.[10]

It is important not to give excessive attention to the failure and closure rates. However, as David Birch has pointed out, the difference between growing and declining areas of this country is not the job loss rates, which are remarkably constant at about 8 percent a year, but rather the job creation and firm formation rates.[11]

Job quality in young and small business is often low. If one compares self-employment wages and benefits to comparable jobs in larger firms, then it looks like they pay about 70 percent as much as their larger counterparts and often fewer benefits.[12] But for many people, self-employment is an alternative NOT to employment in a large firm, but unemployment. A study recently completed by the Wisconsin Department of Development using U.S. Census data found that one's chances of making more than $8,000 was virtually the same through self-employment as through wage and salary employment (77.9% versus 80.4%). As the dollar threshold goes up, the likelihood of exceeding it is actually greater through self-employment than through wage and salary employment.[13] Moreover, different benefit and support structures could improve the performance.

3. Barriers to Self-Employment

That a significant number of dislocated workers choose self-employment is testimony to desire and necessity, not ease. Significant barriers to self-employment confront any dislocated worker choosing this option. Four types of barriers seem particularly significant:

1. Cultural Support: The conventional view of an entrepreneur is that of a white male engineer in his mid-thirties starting a high-tech business backed by venture capital. This is not an accurate description of the 600,000 to 1 million Americans who will start businesses this year, nor is it an accurate description of all the people who could start businesses. But it is a powerful disincentive to people who do not fit the stereotypes, and to those who must lend support -- financiers, accountants, lawyers, trade associations. In a community where son has followed father to work in the same plant for generations, the idea that he might work for himself is one that needs some nurturing.

2. Financing: this country relies on an informal system of personal savings and savings of friends, family, and associates to provide those small amounts of seed money with which an entrepreneur translates a vague idea into an actual business. While this is a financing system that works remarkably well on the whole, and probably dwarfs the venture capital industry in size, it is a financing system that does

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10 See Kibre Dawit and Robert Friedman, "Myths of Small Business Failure," Entrepreneurial Economy, 1:1 (July 1982).

11 David Birch, Op cit.

12 U.S. Small Business Administration, Op cit.

13 Expanding Self-Employment Opportunities in the Great Lakes Region (Madison, WI: Wisconsin Department of Development, 1987).

not work as well in low-income communities, or in communities hard hit by plant closings. Banks are also often unlikely to meet the financing needs of growing businesses. It is significant that in a survey of its membership, the National Federation of Independent Business found that by and large small businesses felt their credit needs were being met quite well by the banking industry; the small percentage who said their needs were not being met were, however, precisely those businesses that were growing -- whose capital needs this year were different from their capital needs last year.

3. Entrepreneurial Skills: People who want to and could start businesses are often unable to do so successfully because they lack the skills necessary to start a business -- and access to the training that might provide them with those skills.

4. Policy Barriers: The unemployment compensation system itself sets up barriers to self-employment. In fact, in most U.S. jurisdictions the only thing an unemployed person can do safely without jeopardizing his or her receipt of unemployment compensation is to search for a comparable job -- however unlikely its emergence. The dislocated worker who tries to start a business becomes ineligible for benefits since he or she is no longer ready, available and searching for work.

4. Precedents and Program Models

Until recently, European countries, like the U.S., penalized unemployed workers for pursuing self-employment. But in the last eight years nine European countries (Britain, France, Belgium, Ireland, Spain, The Netherlands, Denmark, Sweden), Australia, and Canada have moved to remove such disincentives and otherwise encourage and enable self-employment. Great Britain and France have the most extensive programs.

France's "Chomeurs Createurs d'Enterprises"

The first and most extensive use of transfer payments as a form of self-employment capital is France's "Chomeurs Createurs d'Enterprises" (unemployed entrepreneurs) program, introduced on an experimental basis in 1979 and made national policy one year later. Today French citizens entitled to unemployment compensation or welfare can collect up to 43,000 FF (around $6,500) in a lump sum to start a business. This can increase to as much as 50,000 FF if the entrepreneur creates an additional job within six months. Program participants also receive social welfare coverage (health, maternity, accident, disability, life insurance) while in the program. Since its initiation, more than 175,000 French citizens have opted for the scheme.

Enterprises begun under the program span the range from high technology manufacturing to janitorial services. Evaluations of 24,606 businesses started during 1981 and 1982 found that: between 60 and 80 percent of the businesses survived at least one year and that of those entrepreneurs whose businesses closed, more than half had either found a new job or started a second business. The average lump sum benefit was equivalent to $2,467 (1982/1983) with which 30 percent of the beneficiaries were able to leverage additional bank loans. On average, the participants created two jobs each (their own plus one). Twenty percent had no post-secondary school diploma and their average previous duration of unemployment was 7 months. 50.7 percent of recipients said they would not have started their business but for the program; an additional 25.8 percent doubted whether they would

have otherwise. Remarkably, over a third of all businesses formed in France last year were financed in part under the scheme.

Britain's Enterprise Allowance Scheme

Great Britain's Enterprise Allowance Scheme (EAS) takes a different tack by supplying people with weekly benefits equivalent to average UI benefits while they attempt their business start-up. Since 1982, more than 200,000 people have started up enterprises through EAS and the scheme has subsequently been copied by Ireland, the Netherlands, and Sweden.

The U.K.'s program was premised on the belief that some unemployed people would start their own businesses if they weren't threatened with the loss of their jobless benefits. The government also believed that by virtue of the scheme, some underground business activity would come above ground, pay taxes and expand. The EAS, operated by the central government's Manpower Services Commission (MSC), pays "unemployed entrepreneurs" a uniform 40 Pounds ($60) a week for up to a year to supplement the receipts of their enterprises until they can establish themselves. Other programs also provide access to a wide range of free business training and counseling services.

To be eligible, the entrepreneur must meet all the following conditions: be receiving unemployment or supplementary (the British equivalent of welfare) benefits, have been unemployed for at least 18 weeks (13 weeks until April 1986) before applying, have at least 1000 Pounds ($1,500) available to be drawn upon, be between 18 and normal retirement age, and have a legal business in mind.

Interested applicants first attend a "scaring-off" session, originally only two hours but now a full day, where they meet with job counselors, tax experts, accountants and lawyers, and are informed of the risks and difficulties involved in starting a business and, recently, of sources of assistance. Those who want to go on fill out a simple form with very little red tape.

The scheme began in five pilot areas in early 1982. One year later, more than 2,000 people were participating, and the government agreed to extend it nationwide, with a ceiling of 25,000 entrepreneurs through March 1984. By November 1983, with entrants joining the EAS at a rate of 800 a week, the annual target for 1983/84 had already been exceeded and was raised to 35,000. In April 1984, the target was raised yet again to more than 50,000 places a year. Demand remained unsatisfied and in November 1984, a target of 65,000 was announced. Again to meet demand, the 1986/87 target was set at 86,000 new entrants and the 1987/88 target at 100,000. Overall, about two percent of Britain's eligible unemployed have chosen the self-employment option.

Although it is too early to obtain definitive figures on the national scheme, recent studies show that of the firms begun during the EAS pilot phase, 52 percent were still trading 3 years after start-up. Surveys of the nationwide program also suggest that each surviving enterprise has created an average of 1.5 jobs.

Overall, about 40 percent of the EAS participants say they would not have started an enterprise without the scheme; another 30 percent say they would not have started one as soon; 70 percent said they would probably have failed without the EAS assistance. Twenty-eight percent of EAS participants take a cut in income to

enter the scheme. During the first 9 months, income levels of participants are substantially below the national average, but exceed it after 18 months.

The MSC estimates the net cost per net new job created through the scheme (discounting for business closures, businesses that would have been started anyway and displacement of existing businesses) is 2,690 Pounds ($4,000) during the first year. Additional tax revenues and cost savings in the second year reduce the net cost to 665 Pounds ($995); by the end of the third year, MSC estimates the Exchequer actually makes money through the scheme.

U.S. Experience

During the last several years, there has been growing local and state experimentation in the U.S. with promoting self-employment and entrepreneurship among dislocated workers.

Several states and Private Industry Councils have used JTPA money to fund entrepreneurial training programs. Ohio, for example, has used $550,000 in JTPA Title III funds to train 217 dislocated workers to start businesses. State vocational education systems, community colleges and universities have also provided such training.

Some states, localities, and private agencies have established seed capital and revolving loan funds. Recently the U.S. Department of Labor awarded the State of Washington, which had been alllowing dislocated workers undertaking entrepreneurial training to continue to receive UI benefits under the "state approved training" provisions of the enabling legislation, $2,000,000 to demonstrate the feasibility of extending lump-sum allowances. But the experience to date in this country has been piecemeal and inconsistent.

5. Pursuing the Experimentation

There is much we do not know about the results of opening a realistic self-employment option for unemployed and dislocated workers in this country. Clearly, we are different -- economically, socially, politically, institutionally -- from Europe. Nor do we know how best to open such an option: by simply removing risk of loss of benefits, establising a certain stream of weekly benefits, advancing benefits as lump sums, or providing a comprehensive support system of entrepreneurial training, bank relationships, seed capital, and peer support. We do not know how best to screen or target a program to the beneficiaries and areas most likely to yield attractive results.

What is clear is that we will never know the answers to such questions unelss we begin to experiment -- thoughtfully, carefully, seriously -- with various approaches. Clearly, the time is ripe for such experimentation: the experience of other countries seems attractive; unemployed and dislocated workers in this country are choosing the option, in spite of barriers set in their way; and states are interested, even if they must absorb the risks (of higher costs, novelty). When the National Governors' Association and the Corporation for Enterprise Development held a conference on "Expanding Entrepreneurial Opportunity: An Alternate Route to Self-Sufficiency," more than 41 states sent representatives.

The self-employment allowance provisions of H.R. 3545 and H.R. 2676 will foster some of the experimentation that must occur if we are ever to be able to adequately assess the potential of this option. In endorsing the greater leeway, the pending legislation

would allow states to experiment with opening a self-employment option. I would like to suggest three guidelines for pursuing the experimentation.

1. Adequate experimentation given the range of demographic, economic, institutional, policy, programmatic and geographic variables with which we are dealing (a relatively large number of different states) should be allowed to explore the territory.

2. The leeway granted states to experiment should be in direct relation to the insulation granted federal interests.

3. All experiments should be evaluated.

I want to thank this Committee for considering the proposed legislation and for allowing me to submit this testimony.

STATEMENT OF HON. WILLIAM J. COYNE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman, thank you for this opportunity to testify on proposed reforms to the Federal-State Unemployment Compensation System.

There is a particular problem in my state of Pennsylvania with the current method by which employers are assessed additional unemployment taxes above the amount needed by the state to repay outstanding federal loans. Many of us in Pennsylvania are concerned that this inequity may be hampering the creation of new jobs in the state.

Under the existing Federal Unemployment Tax Act, employers located in states with delinquent federal loans must pay into the FUTA tax fund at penalty rates. Those rates increase each year the loan remains unpaid. In the case of Pennsylvania, which will owe approximately $203 million to the federal unemployment fund at the beginning of 1989, employers will pay a surcharge that would collect more than double the amount owed by the state. Under the rate that will be assessed in 1989, Pennsylvania employers will pay $475 million to the state. That amounts to $272 million in surplus funds.

The entire tax collected from employers, including the penalty charge, is deposited in the state unemployment trust fund and cannot be used for any purpose other than paying unemployment benefits.

It makes little, if any, sense to let those funds lie idle in the state's unemployment trust fund. Nor does it seem fair to require companies in the state to pay such an excessive sum above what is needed to repay the federal government. This money, if left in the hands of employers, might be better used for such things as new or expanded plants, research and development, job creation programs or to increase capital investment by Pennsylvania corporations. Furthermore, I am concerned that this penalty situation may be discouraging prospective employers from locating in Pennsylvania.

In effect, unless Pennsylvania pays back the remaining balance on the federal loan and no penalty tax is assessed, the current law would withhold more than a quarter of a billion dollars from the Pennsylvania economy. Ancther concern is that the current penalty provision may be stifling business investment in Pennsylvania and could adversely affect the economic growth plans in other states in the future if left unchanged.

One possible solution I would strongly urge the subcommittee to consider is a bill introduced by my distinguished friend and colleague from Pennsylvania, Congressman Gus Yatron. This bill sets a cap on the amount of penalty tax that can be charged to employers. In addition, this bill would protect employers from paying more than the amount due by a state to the federal government. These safeguards could result in additional business investment in states and help create new jobs. This legislation would correct an obvious inequity in the current law.

It is important to note that this proposal would not forgive any state's obligation to repay loans to the federal government's unemployment trust fund.

Instead, the legislation would give companies a greater opportunity to pump that money into local economies where it could save, and possibly generate, jobs.

I strongly urge the subcommittee to support Congressman Yatron's bill H.R. 2801 and correct this inequity in the law.

WILLIAM J. COYNE
PENNSYLVANIA
14TH DISTRICT

COMMITTEES:
WAYS AND MEANS
STANDARDS OF
OFFICIAL CONDUCT

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Congress of the United States
House of Representatives
Washington, DC 20515

December 21, 1987

The Honorable Thomas J. Downey
Acting Chairman
Subcommittee on Public Assistance and
Unemployment
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I am requesting your permission to include Senate Concurrent Resolution Serial No. 122 of the Pennsylvania State Senate in the Committee files for review and use by the Committee.

The resolution, passed by the Senate of the Commonwealth of Pennsylvania on October 6, 1987 and concurred in by the Pennsylvania House of Representatives on October 28, urges the Congress of the United States to support an amendment to Section 3302 of the Federal Unemployment Tax Act to limit the credit loss penalty applicable to employers and to prevent overpayment of FUTA debts. I have enclosed six copies of the Senate Resolution for the Committee's use.

With every best wish, I remain

Sincerely,

William J. Coyne

William J. Coyne
Member of Congress

WJC:jr

Senate of Pennsylvania

HARRISBURG, PA.

OFFICE OF THE SECRETARY

In the Senate, October 28, 1987

Whereas, Due to economic downturns and double digit unemployment, Pennsylvania's unemployment compensation system was compelled to borrow a substantial amount from the Federal Unemployment Account in order to meet compensation payments; and

Whereas, The system and Pennsylvania employers were unable to repay this debt by the originally established deadline and therefore became subject to a "credit loss penalty" which increases annually; and

Whereas, This accumulated penalty has placed and will continue to place a burden on Pennsylvania employers, averaging $126 per employee in 1988; and

Whereas, By 1989, this penalty will exceed the amount of the debt by more than $272 million; and

Whereas, A coalition of Pennsylvania employers, unions and the General Assembly has made successful efforts to restore the fiscal integrity of the unemployment system and to repay interest-bearing and noninterest-bearing debts; and

Whereas, This projected overpayment can be avoided if the Federal Unemployment Tax Act is amended to cap the automatic accrual of penalties and reduce the penalty in the last year of debt repayment; and

Whereas, Such amendments to the Federal Unemployment Tax Act are currently being considered in the United States Senate (through S 1254) and the United States House of Representatives (through HR 2801); therefore be it

Resolved, (the House of Representatives concurring), That the General Assembly memorialize the Congress of the United States to support and enact an amendment to section 3302 of the Federal Unemployment Tax Act to provide limitation on the credit loss penalty applicable to employers with outstanding loan balances, and to prevent overpayment of the debt; and be it further

Resolved, That copies of this resolution be transmitted to the presiding officers of each House of Congress and to each member of Congress from Pennsylvania.

I certify that the foregoing is a true and correct copy of Senate Concurrent Resolution Serial No. 122, introduced by Senators William J. Stewart, Edward P. Zemprelli, John J. Shumaker, M. Joseph Rocks, Roger A. Madigan, James A. Romanelli, Jeanette F. Reibman, Roxanne H. Jones, Ray C. Afflerbach, Vincent J. Fumo, J. Barry Stout, H. Craig Lewis, Michael A. O'Pake, Anthony B. Andrezeski, James E. Ross, Patrick J. Stapleton, James C. Greenwood, Frank A. Salvatore and D. Michael Fisher, and adopted by the Senate of the Commonwealth of Pennsylvania the sixth day of October, and concurred in by the House of Representatives the twenty-eighth day of October, in the year of our Lord, one thousand nine hundred and eighty seven, and of the Commonwealth the two hundred and eleventh.

Mark R. Corrigan
Secretary
Senate of Pennsylvania

SEAL OF THE SENATE OF PENNSYLVANIA

December 22, 1987

The Honorable Thomas J. Downey
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Mr. Chairman and Members of the Subcommittee:

My name is Gary Adkins, I am President of the International Association of Personnel in Employment Security (I.A.P.E.S.) and I am submitting testimony to you in behalf of our 26,000 members nationwide. I.A.P.E.S. is an organization of those individuals that are the workers in the Employment Security offices throughout the nation. They are employed in Unemployment Insurance, Job Service, Job Training and Labor Market Information. Thank you for the opportunity to comment on the Unemployment Insurance Program.

I am responding to the questions listed in the subcommittee's press release number seven and would also like to comment on Administrative financing concerns and the need for an Unemployment Insurance National Task Force.

1) Do the states have sufficient reserves in their unemployment funds?

We believe that the 70's and 80's have proven that the state Unemployment Insurance funds have a serious solvency problem with 38 states finding it necessary to borrow during this time period. All reports indicate to us that should the nation have a serious nationwide recession for any period of time, most states would find it necessary to borrow unemployment insurance funds.

2) Do existing programs provide adequate coverage of the work force?

93% of all workers are covered by the Unemployment Insurance Program but only 25.4% of the unemployed receive UI Benefits.

The number of unemployed individuals who receive unemployment benefits today is a smaller percentage than it was ten years ago. We believe this is one of the issues that requires an additional study.

3) Would the current Federal-State Extended Benefits program provide the additional protection needed during a period of high unemployment?

The Federal changes in the 80's to the Extended Benefits Program have added restrictions in both qualifying and eligibility that have limited the Extended Benefits program in meeting the needs of the long term unemployed. We strongly support the Extended Benefits program but it should be modified so it would better meet the needs of the long term unemployed.

4) **Has the stabilizing effect of unemployment compensation and public assistance programs during periods of high unemployment been impaired because of reductions in these programs that have been enacted in recent years?**

The Unemployment Insurance Program has been a stabilizing economic force in periods of high unemployment over the last 50 years. The reduction in Administrative funding has reduced the timeliness of payments to claimants and the quality of the Unemployment Insurance Program.

5) **Are there alternative uses of UC funds that could improve the efficiency of labor markets?**

Test projects have been and should be continued to look for alternative uses of Unemployment Insurance in meeting the needs of claimants. However, these programs should be critically evaluated for their impact, their costs and if they are found to be effective, they should be funded from general funding sources rather than the Unemployment Insurance Trust Fund.

Administrative Financing Concerns

Funds are collected through the Federal Unemployment Tax for the purpose of financing the administration of Unemployment Insurance and the Employment Service. In the past several years through the Federal budgeting process these programs have been cut several times causing reduction in services to employers, claimants, and the closing of offices. I.A.P.E.S. believes that all Unemployment Compensation Trust Funds including the Administrative Account should be removed from the Federal unified budget and that these funds be dedicated for Unemployment Insurance benefits and the administration of Unemployment Insurance, Employment Service and Labor Market Information programs. If these funds were so dedicated the states would have adequate funding to perform their responsibilities.

National Task Force on Unemployment Insurance

We appreciate your interests and concerns in studying the Unemployment Insurance Program but would like to have you consider a more in depth review of the program.

We believe a bipartisan national task force should review the Unemployment Insurance program completely considering: the future, financing, extended benefits, reserves, coverage, etc.

Our Association would be glad to provide input in this review.

Again Mr. Chairman, I thank you for the opportunity to discuss the Unemployment Compensation Program.

Sincerely,

Gary Adkins

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National Federation of
Independent Business

NFIB

SUBMITTED STATEMENT OF

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: House Subcommittee on Public Assistance and Unemployment Compensation

Subject: Re-examination of the Unemployment Insurance System

Date: December 19, 1987

Mr. Chairman, NFIB, on behalf of the more than 500,000 small businessmen and women who are its members presents the following testimony on the subject of the unemployment compensation (UC) system, with emphasis on H.R. 2676 and H.R. 3213 bills pending before the subcommittee.

NFIB is a trade association representing over 500,000 small businessmen and women around the country. Our members employ about 7 million people. NFIB members range across all industries, with an average employment per firm of 10 employees. These are Main Street small businesses -- they are the backbone of the local economy, and consequently the national economy.

Over the past decade small firms have been responsible for over 70% of the more than 14 million net new jobs created. The reason for this phenomenon is that small firms hire people -- not machines -- to work. People are a small firm's most important as well as most expensive resource. That is why payroll tax issues, like Social Security and in this case, unemployment insurance (FUTA), have such a tremendous bearing on the health and viability of small businesses.

It is important to recall the reasons for establishing the UC program over 50 years ago and that it has been successful in meeting the needs for which it was designed.

The UI system was designed to:

*provide temporary cash benefits to those out of work through no fault of their own;

*provide for additional circulation of money during economic downturns; and

*assist the unemployed in finding gainful employment.

This re-clarification will explain why the bills under discussion before this subcommittee today, with their emphasis on using the UI system for alternative programs, are fraught with danger and disaster for the current system.

In 1935, Congress adopted the federal unemployment insurance program as part of the Social Security Act, part of which included the Federal Unemployment Tax Act (FUTA). This was the first comprehensive federal approach -- prior to this time, some individual states had taken the lead in establishing programs of this type for their citizens. For the first time, the federal government took the initiative by adding incentives and penalties to encourage participation. As a result, every state that did not have a state unemployment insurance (UI) program prior to 1935 adopted legislation so that they would be able to take advantage of the FUTA tax credit available to employers whose states had a state program in place.

As the subcommittee knows, the FUTA tax is a flat 6.2% levy on the first $7,000 of wages of each employee. There is a 5.4% FUTA credit allowed for state UI taxes paid, making the effective tax 0.8%. Part of this 0.8% is the temporary 0.2% tax levied in the mid seventies by the Congress to help pay off trust fund debt incurred through the payment of extended benefits.

This temporary tax, already ten years old and scheduled to be lifted on January 1, 1988, has now been extended for three additional years. Literally days before small businessmen and women would have been provided some relief from this regressive payroll tax, Congress choose to play the Grinch instead of Saint Nick.

FUTA tax funds are used to finance state and federal administrative costs of the UI program, the 50% federal share of the Extended Benefits program, and a loan fund for states that need money to temporarily bolster state trust funds. The federal government sets certain basic requirements that states must meet in order to be in conformity with federal law and eligible for the FUTA tax credit.

Whereas FUTA is a flat-rated tax, state UI taxes are experience-rated, ie. graduated tax schedules based upon layoff experience. The state taxable wage base varies among the states, but must be at least $7,000 under federal law. State taxes are used to pay UI benefits. This tax on labor is paid exclusively by the employer, except in four states that impose a very minimal tax on employees.

As you may know, NFIB regularly polls its members on policy issues both at the federal level and in each of the fifty states. The issue of unemployment insurance is a continuing concern to our small business members because it is directly related to employment, wages, and labor costs.

On the overall structure of the UI system, NFIB members strongly support efforts to provide a more fully experience-rated system than is currently in place in most states (78% favor to 16% oppose -- Mandate #463). Small firms with stable workforces typically subsidize employers in declining industries with large layoffs. This socialization unfairly penalizes good, stable, small employers and rewards those larger employers who have had high levels of employee turnover.

NFIB members supported, by a margin of 83%, the change enacted in 1981 in which the national trigger for extended federal benefits was eliminated and state triggers were substituted. This change more accurately reflected the differing employment situations in the states. States with relatively low unemployment no longer have to expend funds due to states with higher unemployment rates.

NFIB members also voted in 1985 against the creation of sub-state triggers (65% against). This view is supported by the results of a May, 1984 study on this very issue by the Department of Labor, conducted at the request of Congress.

Congress asked the DOL to determine the feasibility of using substate areas for the payment of unemployment insurance. The conclusion to the study reads in part:

> It must be said that the basic data elements necessary for creation of a substate benefit program do not exist in a form which makes establishment possible within existing administrative, program or state legislative constraints... it is not possible to measure with sufficient accuracy the unemployment rates for those areas and create a program which is similar to the existing UI program without extensive revisions in the amount and type of data collected and in UI administrative mechanisms.

The legislation that has been introduced to date, part of which is the subject of today's hearing, do not address the real world questions posed by the DOL study. DOL states that Total Unemployment Rates (TURs) are much less accurate than the Insured Unemployment Rate, yet that is precisely the method chosen by H.R. 2676 as a measure for payment of benefits. Further, the DOL study states that only ten states and two metropolitan areas have the ability to provide TUR figures that meet the Bureau of Labor Standards' measure of reliability. Additionally, the report finds that the accuracy of data used to compute the TUR for an area diminishes as smaller and smaller areas are used. The findings of this report should give the subcommittee pause as you examine the merits of H.R. 2676.

One of the complaints we hear most often from small business owners regarding the UC system is the unfair treatment of owner-employees. After having paid their FUTA taxes, small business owners are many times denied unemployment benefits if their firm should either go out of business, or if they lay off all their workers due to the seasonal nature of the business, like construction. NFIB members voted by a margin of 72% in favor of exempting employers from payment of UI taxes if they are ineligible to receive UI benefits. This is another example of small business owners subsidizing benefits. Corrective action can be taken at either the state or federal level. In fact, legislation was introduced in the 99th Congress by Senator Kasten (R-WI) to accomplish the goal of making owner-employees eligible for unemployment compensation.

That point leads me directly into our comments on H.R. 3213, which provides for demonstration projects on alternative uses of the UC system. H.R. 3213 would fund pilot projects for: relocation allowance; reemployment bonus allowance; economic adjustment allowance and finally a self-employment allowance. H.R. 2676 also contains a provision relating to the establishment of a pilot program for a self-employment allowance.

The current UI system has worked well over the past fifty years with its limited and specific goal of providing temporary replacement income to unemployed individuals. The funding, structure, and delivery system of the UC program is not, in our view and that of many other experts in the field of unemployment insurance, capable of expansion into alternative areas, nor should it be.

If Congress wants to explore alternatives to alleviate unemployment, then the members of this subcommittee and your colleagues in the House should request additional general revenues for that purpose. If dislocation of workers and retraining are societal problems, then they need to be addressed in the larger context of the range of competing interests and needs that Congress must consider. To say it is solely an employer problem, or that it is a societal problem but employers should bear the whole burden for the solution, is poor policy at best.

The fundamental question we face on this issue -- as on several others pending before the 100th Congress such as parental leave and mandated health -- is, who pays? In the European programs that supporters of H.R. 2676 and 3213 point to, much of the program support comes from general revenues -- very little if any is supported by employer-paid taxes, as is the case here in the United States.

In America, the UI program, both state and federal, is supported solely by an employer-paid tax, notwithstanding the extremely few exceptions noted earlier. This important fact colors all discussion of whether or not to expand the UI system to alternative uses. The amount of money available to fund the UI system is fixed -- it increases slowly as job opportunities and employment duration increases.

As the General Accounting Office (GAO) noted in its testimony before the subcommittee, the UI system after five years of economic recovery is still financially fragile. The GAO recommended that Congress would find that its efforts and resources better directed toward improving the adequacy of the reserves, thereby minimizing state trust fund insolvencies and borrowing by states from the federal government. In this light, demonstration projects designed for alternative uses of UC will only exacerbate a situation that is stable but still precarious at present.

Of the alternatives proposed for UI funding, the one for a self-employment allowance troubles us most. As representatives of small businesses, NFIB is a strong and longstanding supporter of the free enterprise system. We are proud of the men and women who are the risk takers in our society, who are willing to put up their savings, their time and effort, to bring their idea to reality. That is the very spirit of entrepreneurism.

NFIB has recently completed a longitudinal study of small firms in their first three years of existence. According to the survey, the most frequently used source of capital to start a small business was personal savings. The next most cited source was borrowing from friends or relatives. The point I am trying to make is that these individuals have made a conscious decision as to the choice they want to make and are willing to sacrifice to achieve the goal of owning their own business.

The self-employment allowance, while it may sound novel and worthwhile, is seriously flawed from our perspective, especially the versions contained in both H.R. 2676 and H.R. 3213. Once again, it goes back to the point of funding sources for the UI system. In effect Congress would be mandating that an employer, who pays FUTA taxes on an employee, directly subsidize the creation of a new small business by that previous employee.

Whether intentional or not, you would be asking a current small business owner to pay a previous employee to go into direct competition against them. That, Mr. Chairman, and members of the subcommittee, is not free enterprise; that is not entrepreneurism.

Last week the subcommittee had the opportunity to listen to expert testimony from Mark Bendick and Mary Lou Egan on this very same point. They presented testimony on their comparative analysis of entrepreneurial programs in Western Europe and how that experience would relate to proposals for similar legislation here in the United States. Their conclusion, though for different reasons, is the same as that expressed above. From an academic review of the situation in both France and Great Britain, the conclusion reached was that "such [self-employment] allowances would be of questionable utility." The rest of their testimony explains more fully the negative impacts of such a proposal on the UC system and individuals receiving benefits, on small business and economic development. Their concluding paragraph is telling:

> The prime responsibility of the UC trust fund must remain that of providing income maintenance to the temporarily unemployed. Alternative uses of these funds for other purposes might be justified if that use so speeds the reemployment process that the expenditures are more than offset by reduced UC payments. Nothing in the evidence reviewed in this testimony suggests that self-employment allowances should be expected to meet this stringent criterion.

In closing, I would like to state that NFIB and its small business members support efforts to create and expand job opportunities for people. Entrepreneurs do that every day -- the result has been million and millions of net new jobs created in the past decade for American workers. Small business provides 2/3 of

all workers with their first job and provides informal and formal job training. In some sections of the country, our members face labor shortages due to a dwindling supply of available people, especially skilled workers.

The concerns raised by the members of this subcommittee and by the authors of the legislation being considered today are worthy issues that need to be raised and discussed. As I stated above, our small business owners grapple daily with the problem of training and retraining. However, the manner in which the bills would address these needs are, in our view, counterproductive to the goals of the UC system and would jeopardize the financial soundness of the system. In the area of the proposed self-employment allowance, the effect would be a direct subsidization by a small employer, from his or her FUTA tax dollars, of a competitor who was once an employee.

I would like to recommend, Mr. Chairman, that additional hearings be held on this important subject. More information needs to be accumulated and digested before any legislative solution can be proposed and considered by the Congress. The bills before the subcommittee today are not the proper solution to the questions that need to be answered. Thank you.

0313T

THE NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA

"STRENGTH IN UNITY"

Statement of

Richard W. Johnson, Jr.
Director of Legislative Affairs

Submitted to the

Subcommittee on Public Assistance
and Unemployment Compensation
Committee on Ways and Means
U.S. House of Representatives

on

Unemployment Compensation

December 14, 1987

NATIONAL CAPITAL OFFICE
225 N. Washington Street • Alexandria, VA 22314 • Tele: (703) 549-0311

The Non Commissioned Officers Association of the USA (NCOA) representing more than 170,000 active duty, reserve, retired and veteran noncommissioned and petty officers appreciates this opportunity to submit its comments on unemployment compensation issues relating to former servicemembers.

UCX

Unemployment compensation for ex-servicemembers (UCX) is generally governed by the provisions of 5 USC 8521. The program has been modified several times in recent years.

In 1980, Congress extended the period of qualifying military service for UCX benefits from 90 to 365 days.

In 1981, Congress changed the qualifying requirements from "release under other than dishonorable conditions" to "release under honorable conditions" and added new provisions prohibiting UCX payments to persons who were separated for cause, resigned, or voluntarily accepted discharge. These provisions, part of a budget reconciliation measure, unfairly prohibited the payment of UCX benefits to honorably discharged servicemembers who completed enlistment obligations but continued UCX program benefits for marginal performers who were denied reenlistment.

In 1982, Congress recognized the inequity of this proposition but was constrained by their earlier cost saving action from providing full relief. As a result, Congress that year partially restored UCX benefits for those who serve honorably. The solution, adopted in 1982, limits former servicemembers to 13 weeks of unemployment compensation beginning no sooner than five weeks after discharge.

The five week delay and 13 week limit on benefits have a tremendous adverse impact on recently discharged servicemembers and their family. Most young people who fulfill a patriotic obligation of military service have no intention of making the armed forces a career. Neither is it desirable for the U.S. to retain all recruits for career service. Such an action would "age" the force, stagnate promotion opportunity, increase the cost of maintaining a standing force and increase the cost of military retirement. Instead, the U.S. must count on a rotation of young people, willing to serve three to six years, to man the force. At the same time, the U.S. should be willing to reasonably support these people through the difficult transition of returning to civilian life.

There is no sound reason to delay unemployment benefits for five weeks. Yet the delay serves to the disadvantage of those military personnel and their families who must make the transition and creates an unnecessary burden on those who have served. The 13 week limit also creates an unnecessary burden on families in transition and is equally without basis. Further, the most adverse impact is on those unskilled servicemembers who are least likely to be retained in service and who need the greatest readjustment support.

The problem is now magnified by the impact of budget cuts which will force the services to select up to 70,000 people for involuntary or early separation this year. These people will be given little, if any, time to prepare adequately for transition. And, like most servicemembers, they will probably be discharged from military installations more than a thousand miles from home, precluding any reasonable opportunity to seek post service employment prior to discharge.

No other group receives the same kind of disparate treatment in unemployment compensation issues as this nation's veterans. No waiting period is assigned to others. Supplemental benefits are not denied others on the basis of past employment. Honorably discharged veterans should be no different. NCOA urges the committee to repeal 5 USC 8521 (c).

Reserve Benefits

On a somewhat different subject, NCOA seeks congressional support for an initiative to standardize the treatment of drill pay in computations for unemployment benefits.

The nation has long recognized the economy and desirability of maintaining an armed forces reserve. Currently reserve and national guard units comprise almost 40 percent of the defense establishment. Reserve components are currently vested with most of the nation's combat lift capability, about half of all special forces missions and about 40 percent of combat divisions. Reservists participated in the lift to Granada and the evacuation of casualties from Beruit. Reservists also serve today in minesweeping operations in the Persian Gulf. Indeed, reserves are an integral part of the force. Yet, the average reservist is a part-time guardsman, soldier, sailor, airman or Marine.

Most reservists are citizen serviceman. They participate in monthly training drills and summer camps to hone their military skills but they must rely on civilian employment for income sufficient for self and family support. Herein lies the problem.

In many states, pay received as a guardsman or reservist (drill pay) is excluded from computations used to determine eligibility for unemployment compensation. Thus, when a factory worker is laid-off he or she can continue to participate in the reserves and draw full unemployment compensation based on the loss of regular employment. Unfortunately, some states do not give such special consideration to the value of reserve service and use drill pay to reduce or prohibit unemployment compensation eligibility when regular employment is lost. Accordingly, many reservists must quit their military commitment to protect their unemployment compensation or they must accept the reduced benefit and its associated impact on their family. Meanwhile, employers and states profit from the reduced obligation to pay unemployment benefits to members of reserve components.

NCOA urges the committee to draft legislation excluding drill pay as disqualifying income in unemployment benefit determinations and expressing "sense of the Congress" support for providing full unemployment compensation to reservists who have lost regular employment.

Thank you for your consideration.

-end-

Congress of the United States
House of Representatives
Washington, D.C. 20515

Statement of Congressman Pete Stark
on Reform of the Unemployment Compensation Program
for hearing on Monday, December 14, 1981

A Case for Relocation Assistance, Retraining and Education for Unemployed People

Mr. Chairman, I would like to commend you for holding these hearings on reform of the Unemployment Compensation (UC) program. Since this is a stable time for unemployment, it is a good period to address the issue.

For awhile, I have been interested in demonstration projects which would test the idea of providing a worker's probable U.I. benefit in a lump-sum, to be used in a retraining program or for relocation assistance. These projects would be set up in an area of high unemployment caused by industry which relocated or closed down.

Title II of H.R. 3213, introduced by Mr. Levin, Mr. Pease and Mr. Ford of Michigan, suggests this experiment. I compliment the sponsors of the bill and encourage the Subcommittee to support and strengthen this portion of the bill.

For example, if relocation assistance, retraining or education had been available to people from the metropolitan area of McAllen - Edinburg - Mission in Texas, the area would not be suffering a 19% unemployment rate. Instead, early in the period of eligibility for regular UI benefits, people could have obtained the cash value of the various extended UI benefits, giving them the capital to relocate or for education programs.

I believe cash to relocate to an area of low unemployment will mean more for most people than cash to begin a small business. It is not as easy to transfer the skills used in manufacturing to those needed to begin a business. Also, the number of small business that a depressed area can sustain is minimal. Since choices will have to be made in the UI program, I recommend up front cash, within a structured program, for relocation assistance, retraining or education.

COMMENTS OF THE HONORABLE GUS YATRON

REFORM OF THE UNEMPLOYMENT COMPENSATION PROGRAM

HEARING BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION

DECEMBER 14, 1987

Mr. Chairman, I want to thank you for this opportunity to submit my comments on reform of our Nation's unemployment compensation system. I commend you for holding these important hearings. Although observers may disagree on different approaches to reform, there is no question that some reform of the Federal-State unemployment compensation system is necessary. I'm optimistic that these hearings will help guide us toward reforms which will help us better address the needs of the unemployed.

I know that the subcommittee is interested in examining general reforms of the unemployment compensation with emphasis on legislation such as H.R. 2676, the Extended Unemployment Insurance Act of 1987, and H.R. 3213, the Unemployment Insurance Reemployment Demonstration Projects Act. These are promising proposals which certainly warrant further consideration. For my own part, I am interested in a specific aspect of our current Federal-state unemployment system--the debts owed by states who borrow funds from the Federal Unemployment Account. I have introduced legislation, H.R. 2801, in an effort to address this issue.

As you all know, one purpose of the Federal Unemployment Account (FUA) is to provide funds to states which exhaust their own unemployment insurance trust funds. This often occurs when states are hit with economic recession. In the 1970's, Pennsylvania, Ohio, Michigan, Illinois, West Virginia and several other states borrowed from the Federal trust fund. More recently, Texas and Louisiana have borrowed funds.

As we would all expect, these funds must be eventually repaid by a deadline established by the U.S. Department of Labor. Repayment can occur through an additional assessment on employers or through other means. If the deadline is not met, the loan repayments are accompanied by a FUTA tax penalty. The penalties, which are determined by the U.S. Department of Labor, are assessed at a rate of 0.3% per year and accumulate until a state's debt is repaid in full.

Since these penalties accumulate over time, they get larger and larger each year. When a debtor state reaches its last year of debt repayment, the penalties can often greatly exceed the amount of outstanding debt. In my mind, this constitutes an "overcharging" of employers in debtor states.

A few examples will help better explain this situation. In my home state of Pennsylvania, our last year of debt to the FUA will be 1989. At that time, the outstanding debt is estimated to be $203 million. However, because of the ever-increasing penalty rate, Pennsylvania employers will be forced to pay penalties of approximately $475 million. This constitutes an overpayment of $272 million. A similar situation exists in Ohio this year. Ohio employers are expected to make an excess payment of $130 million in January 1988. As other states move toward the final year of outstanding debt, they will face similar problems. This excessive overpayment places a severe burden on employers. It restricts the amount of capital available to expand and hire more workers. These excess payments can only delay a state's recovery from a recession.

I don't think that these problems were expected when the system was first established. In an effort to address this problem, Senator John Heinz has introduced S. 1254 in the Senate and myself and Congressman Tom Ridge have introduced H.R. 2801 in the House. This legislation reforms this current system by placing a cap on the penalty rate and by preventing the "overcharging" of employers in debtor states. Section 2 of this legislation is most important. It prevents "overcharges" by mandating that if FUTA penalties in the last year of debt exceed the amount owed, the Secretary of Labor will be required to adjust the penalty rate to ensure that only the amount owed is collected. No excess payments will be permitted in the last year of debt.

This is a fair proposal. It does not forgive any debt--the full amount of borrowed funds will be repaid. When states have made a good faith effort to eliminate their debts to the FUA, there is no reason why they should be forced to also repay these excessive penalties during the last year of outstanding debt. In Pennsylvania, we have done much to deal with this problem. At one time, Pennsylvania was the largest debtor state in the Nation with a debt of nearly $3 billion. Since that time, the Commonwealth has taken strong action to reduce these debts and we hope to eliminate any outstanding debt by next year. After many years of sacrifice in order to meet their obligations to the Federal government, Pennsylvania's employers should not be saddled with these excessive penalties. This same situation pertains to other states with debts to the FUA.

H.R. 2801 would help remedy this situation. As the Subcommittee continues its investigation of the Federal-State Unemployment Compensation program, I urge you to closely examine this aspect of the system and to support reforms which will help eliminate the problems faced by states forced to borrow from the Federal Unemployment Account.